

2002

# McDONALD'S CORPORATION

Summary Annual Report



## 11-YEAR SUMMARY

DOLLARS IN MILLIONS,  
EXCEPT PER SHARE DATA

	2002	2001	2000	1999	1998	1997	1996	1995	1994	1993	1992
<b>Total revenues</b>	<b>\$ 15,406</b>	14,870	14,243	13,259	12,421	11,409	10,687	9,795	8,321	7,408	7,133
<b>Operating income</b>	<b>\$ 2,113<sup>(1)</sup></b>	2,697 <sup>(2)</sup>	3,330	3,320	2,762 <sup>(3)</sup>	2,808	2,633	2,601	2,241	1,984	1,862
<b>Income before taxes and cumulative effect of accounting change</b>	<b>\$ 1,662<sup>(1)</sup></b>	2,330 <sup>(4)</sup>	2,882	2,884	2,307 <sup>(3)</sup>	2,407	2,251	2,169	1,887	1,676	1,448
<b>Net income</b>	<b>\$ 893<sup>(1,5)</sup></b>	1,637 <sup>(4)</sup>	1,977	1,948	1,550 <sup>(3)</sup>	1,642	1,573	1,427	1,224	1,083	959
<b>Cash provided by operations</b>	<b>\$ 2,890</b>	2,688	2,751	3,009	2,766	2,442	2,461	2,296	1,926	1,680	1,426
<b>Capital expenditures</b>	<b>\$ 2,004</b>	1,906	1,945	1,868	1,879	2,111	2,375	2,064	1,539	1,317	1,087
<b>Treasury stock purchases</b>	<b>\$ 687</b>	1,090	2,002	933	1,162	765	605	321	500	628	92
<b>Financial position at year end:</b>											
Total assets	<b>\$ 23,971</b>	22,535	21,684	20,983	19,784	18,242	17,386	15,415	13,592	12,035	11,681
Total debt	<b>\$ 9,979</b>	8,918	8,474	7,252	7,043	6,463	5,523	4,836	4,351	3,713	3,857
Total shareholders' equity	<b>\$ 10,281</b>	9,488	9,204	9,639	9,465	8,852	8,718	7,861	6,885	6,274	5,892
Shares outstanding <i>IN MILLIONS</i>	<b>1,268</b>	1,281	1,305	1,351	1,356	1,371	1,389	1,400	1,387	1,415	1,454
<b>Per common share:</b>											
Net income—basic <sup>(5)</sup>	<b>\$ .70<sup>(1)</sup></b>	1.27 <sup>(4)</sup>	1.49	1.44	1.14 <sup>(3)</sup>	1.17	1.11	.99	.84	.73	.65
Net income—diluted <sup>(5)</sup>	<b>\$ .70<sup>(1)</sup></b>	1.25 <sup>(4)</sup>	1.46	1.39	1.10 <sup>(3)</sup>	1.15	1.08	.97	.82	.71	.63
Dividends declared	<b>\$ .24</b>	.23	.22	.20	.18	.16	.15	.13	.12	.11	.10
Market price at year end	<b>\$ 16.08</b>	26.47	34.00	40.31	38.41	23.88	22.69	22.56	14.63	14.25	12.19
Franchised sales	<b>\$ 25,692</b>	24,838	24,463	23,830	22,330	20,863	19,969	19,123	17,146	15,756	14,474
Company-operated sales	<b>\$ 11,500</b>	11,040	10,467	9,512	8,895	8,136	7,571	6,863	5,793	5,157	5,103
Affiliated sales	<b>\$ 4,334</b>	4,752	5,251	5,149	4,754	4,639	4,272	3,928	3,048	2,674	2,308
<b>Total Systemwide sales<sup>(6)</sup></b>	<b>\$ 41,526</b>	40,630	40,181	38,491	35,979	33,638	31,812	29,914	25,987	23,587	21,885
Franchised restaurants	<b>17,864</b>	17,395	16,795	15,949	15,086	14,197	13,374	12,186	10,944	9,918	9,237
Company-operated restaurants	<b>9,000</b>	8,378	7,652	6,059	5,433	4,887	4,294	3,783	3,216	2,733	2,551
Affiliated restaurants	<b>4,244</b>	4,320	4,260	4,301	3,994	3,844	3,216	2,330	1,739	1,476	1,305
<b>Total Systemwide restaurants</b>	<b>31,108</b>	30,093	28,707	26,309	24,513	22,928	20,884	18,299	15,899	14,127	13,093

(1) Includes pretax operating charges of \$853 million (\$700 million after tax or \$0.55 per share) primarily related to restructuring markets and eliminating positions, restaurant closings/asset impairment and the write-off of technology costs. (The cash portion of this pretax expense was approximately \$100 million after tax.)

(2) Includes \$378 million of pretax operating charges primarily related to the U.S. business reorganization and other global change initiatives, and restaurant closing/asset impairment charges.

(3) Includes pretax operating charges of \$322 million (\$219 million after tax or \$0.16 per share) consisting of \$162 million of Made For You costs and the \$160 million charge related to the home office productivity initiative.

(4) Includes a net pretax expense of \$253 million (\$143 million after tax or \$0.11 per share) consisting of \$378 million of pretax operating charges noted in (2) above and \$125 million of net pretax nonoperating income primarily related to a gain on the initial public offering of McDonald's Japan. (The cash portion of this net pretax expense was approximately \$100 million after tax.) Net income also reflects an effective tax rate of 29.8 percent, primarily due to the benefit of tax law changes in certain international markets (\$147 million).

(5) In 2002, includes a \$98.6 million after-tax charge (\$0.08 per share—basic and \$0.07 per share—diluted) to reflect the cumulative effect of the adoption of SFAS No. 142, Goodwill and Other Intangible Assets, which eliminates the amortization of goodwill and instead subjects it to annual impairment tests. Net income per share, adjusted for the nonamortization provisions of SFAS No. 142, would have been \$0.02 higher than the amount reported for 2001 and 2000 and \$0.01 higher for 1996–1999.

(6) Systemwide sales include sales by all restaurants, whether operated by the Company, by franchisees or by affiliates operating under joint-venture agreements.

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**S**ince becoming McDonald's Chairman and Chief Executive Officer, I have had one mission: to make this Company great again. By way of introduction for those of you who don't know me, I have ketchup in my veins. I have spent 28 remarkable years with McDonald's—many overseeing the growth of our international presence to more than 16,000 restaurants today. I have a passion for this fabulous System and an intense pride in having participated in McDonald's emergence as the leading global food service organization and one of the world's most powerful brands. So, I was honored when your Board of Directors asked me to take the reins of the Company after a brief retirement from my post as President.

Over the past several years, McDonald's has lost momentum...and lost what it takes to make customers feel special. We have struggled to grow our business in the face of weak and uncertain economic conditions around the world. The result has been disappointing financial performance. This is not acceptable.

It didn't take me long to realize that some difficult—albeit necessary—decisions had to be made.

To start, we are targeting a lower earnings growth rate. Given the nature and size of our business, the prior earnings per share growth target in the 10 percent to 15 percent range is no longer realistic. Yet, we are committed to returning the Company to reliable, sustainable annual sales and earnings per share growth. We also have decided to lower our capital expenditures compared with recent years until we achieve significant improvements in sales, margins and returns at our 30,000 existing McDonald's restaurants. We will concentrate our capital spending on those investments with the greatest potential. This strategic allocation of capital will free up a significant amount of cash, which we intend to use to strengthen our financial position and improve returns to shareholders.

In short, McDonald's is in transition from a company that emphasizes *“adding restaurants to customers”* to one that emphasizes *“adding customers to restaurants.”*

I am confident that the basic McDonald's concept is strong—that we are doing many things right. However, there's no denying that we've disappointed way too many customers. That has to stop. You see, McDonald's has a new boss...it's not me...it's the customer.

We need to improve our restaurant operations: our service must be *consistently* fast and accurate, the ambience in our restaurants must be *consistently* contemporary and welcoming, our food must *consistently* taste good and the customer experiences we provide must be *consistently* relevant and fun. We will monitor improvements in restaurant execution with more stringent measurement processes. We will recognize those restaurants that take good care of the customer and address those that don't. Our franchisees fully support this renewed emphasis on improving the customers' experience, and they are an important part of making it happen.

We don't claim to have all the answers yet, and I'm not promising a quick fix. However, we already have taken action.

WE HAVE DEVELOPED A PLAN to attract new customers and encourage existing customers to visit us more often.

We will upgrade our service. We are improving our training in order to recreate the winning McDonald's hospitality culture.

We will enhance the taste and relevance of our food. We will offer more products that provide the wholesome choices and variety people are seeking.

We will build brand loyalty by promoting Brand McDonald's through relevant marketing and by continuing to build bonds of trust with consumers. We will concentrate our efforts on attracting young adults, kids and moms. We will focus our advertising on the McDonald's experience. We will remind people that McDonald's has a range of price options. We will leverage our equity in Ronald McDonald among kids and adults. We will continue to be involved in our local communities.

We will make McDonald's our customers' favorite place. A place that's comfortable whether they are alone, with family or with friends. A place that's clean, welcoming and contemporary.

In the end, our plan is all about achieving enduring profitable growth. Attracting more customers, more often and creating more brand loyalty is not enough. We intend to do so efficiently and profitably. Together with our franchisees and suppliers, we will pursue opportunities to improve productivity and identify cost savings. In addition, we will put our financial resources to optimal use to maximize our financial strength.

WE ARE TAKING A FRESH APPROACH to growth and innovation with our meal occasion strategy. We will grow sales over the long term by driving innovations that lead to further—possibly even breakthrough—growth, like the kind of growth we saw from innovations such as drive-thru and breakfast at McDonald's.

WE HAVE CREATED AN ORGANIZATIONAL STRUCTURE to support these changes.

In fact, one of the first things I did when I became CEO was to put the most exceptional talent in key positions.

Charlie Bell, our President and Chief Operating Officer, is responsible for driving superior restaurant operations and world-class marketing. Charlie's record of success in establishing McDonald's as a benchmark for operating superiority in his native Australia, coupled with his marketing leadership experience, makes him the ideal choice for this position.

Jim Skinner, our Vice Chairman, oversees the development of growth opportunities through innovation. He also is responsible for aligning staff and line functions in order to leverage our strengths, economies of scale and capabilities. Jim's worldwide restaurant operations experience serves us well in this role.

Charlie, Jim and other key members of McDonald's leadership team are pictured throughout this report. We are committed to restoring this Company to greatness, and I am confident that over the next 12 to 18 months we will ignite a positive change in the momentum of our business.



*left to right* Charlie Bell, President and Chief Operating Officer;  
Jim Cantalupo, Chairman and Chief Executive Officer; and  
Jim Skinner, Vice Chairman

In the end, we will build a rock-solid foundation that can provide reliable top-line and bottom-line growth, and predictable, solid returns on invested capital.

The food service industry is growing around the world, and we are positioned to capture a good portion of that growth.

We will regain the discipline that once exemplified McDonald's—discipline in our restaurant operations, in our monitoring and measurement of those operations, in remaining relevant, in aligning our resources, in our approach to innovation, and in the management of our financial resources.

You can be confident that your management team understands the challenges. We get it! And we have a clear sense of urgency.

We will monitor our performance. We will gauge our success by the degree of improvement in existing restaurant sales, margins and returns. We will continue to act decisively. As shareholders, you should expect nothing less.

While our challenges are great, there are many great things about McDonald's. Last year, we generated \$2.9 billion in cash from operations and served an average of 46 million customers a day. In the stories that follow, many of our successes are depicted.

Before I end this letter, I would like to recognize two Senior Directors, Gordon Gray and Don Keough, who will be retiring at our upcoming Annual Meeting. These gentlemen have made significant contributions to McDonald's over many years, and we thank them.

We are embarking on a new chapter in McDonald's history. Although it won't happen overnight, I have every confidence that McDonald's will once again generate predictable growth in sales and profits. I appreciate the patience and support you've shown us, and I am certain that our actions will produce positive results for our stakeholders.

Very truly yours,

*Jim Cantalupo*  
Jim Cantalupo

*Chairman and Chief Executive Officer, Shareholder*  
March 21, 2003

*At any given moment around the world—*

# McDonald's

WE ARE a simple business.

We have a great Brand.

We have incredible strengths.

We have talented and energetic people.

We have many customers.

We will attract more customers.

We will serve more meals.

We will create more brand loyalty.

We will turn challenges into opportunities.

We will make the most of opportunities.

We will create new opportunities.

We mean business.

# means business.

5

**McDONALD'S IS** the world's leading food service organization. We generate more than \$40 billion in Systemwide sales. We operate over 30,000 restaurants in more than 100 countries on six continents. We have the benefits that come with scale and a strong financial position. We own one of the world's most recognized and respected brands. We have an unparalleled global infrastructure and competencies in restaurant operations, real estate, retailing, marketing and franchising. We are a leader in the area of social responsibility. We actively share our knowledge and expertise in food safety and are committed to protecting the environment for future generations. Yet, we have not achieved our growth expectations for the past several years. So, our challenge is to leverage our strengths to profitably serve more customers more ways more often.

McDonald's also is a local business. We operate neighborhood restaurants. Our owner/operators and local restaurant management teams and staffs typically live in the communities in which they work. We serve delicious meals and snacks to customers who live, work, shop and play in the neighborhoods in which we operate. We host birthday parties for local youngsters. We also give back to our friends and neighbors through local community involvement and by being there with a helping-hand in times of need.

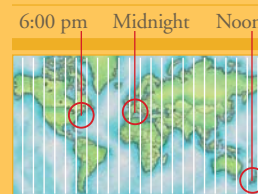
On a typical day, we serve more than 46 million customers. Yet, we serve one customer at a time.

Everyday, McDonald's touches the lives of millions and millions of people. And every moment is a McDonald's moment somewhere in the world.

Despite the challenges we are facing, we also have successes. The stories that follow speak to some of the things that are working at McDonald's around the world. They provide insights into the demand that exists for McDonald's today, what we're doing to bring new and existing customers to our restaurants tomorrow and how we intend to build the business for the long term. They are stories about our global business and our neighborhood restaurants.

## Our Stories >

**AS WE TRAVEL THE WORLD FROM EAST TO WEST, we cross 24 time zones. Noon on Friday in New Zealand is midnight in France and 6 p.m. on Thursday in New York.... But no matter where we are or what time it is, McDonald's means business.**







The eastern coastline of New Zealand's picturesque South Island.

## New Zealand

**IT'S NOON**, and students from St. Andrew's College are enjoying a lunch of Big Mac sandwiches and World Famous Fries at our Merivale restaurant in Christchurch. Adjoining the restaurant is a fabulous McCafé, which was added when the restaurant was remodeled two years ago. Here, the crew serves up frothy cappuccinos and tasty Panini sandwiches. With the restaurant's updated, welcoming environment and the new McCafé, people of all ages consider this McDonald's very cool.



**W**e have a powerful presence in New Zealand, a country with 3.9 million people and 150 McDonald's restaurants. Due to the size of the population, opportunities to profitably add restaurants are limited. Nevertheless, the desire to continue to grow sales and profits remains strong.

Two years ago, Company employees and owner/operators embarked on an ambitious campaign to give McDonald's New Zealand a fresh, sophisticated image. We wanted to create a new McDonald's for the new millennium, and we've done just that!

A combination of rebuilds, renovations and reimagining has given the business the fresh edge we had been seeking, and with it came impressive increases

in comparable sales and improved profitability in New Zealand.

We created a new, hip mood by replacing fluorescent lights and plastic seating with ambient lighting and sleek wood paneling. In some cases, a McCafé — a McDonald's coffee concept with a distinct adult appeal — has been incorporated into the revitalized restaurant's design. At the McCafé, customers can enjoy steaming cups of premium and specialty coffees, along with a variety of pastries and Panini and croissant sandwiches. Some customers even like to mix it up a bit, as evidenced by a sighting of a customer with two Big Mac sandwiches and a latte on his tray.

But don't let the focus on sophistication fool you. McDonald's always will be

**rebuilds, renovations and reimagining have given our business in New Zealand a fresh edge**

a special place for kids. Nearly all of our restaurants in New Zealand have PlayPlaces,

many of which have been updated along with the rest of the restaurant. Our broad appeal is best illustrated by the moms who now make McDonald's a regular meeting place. They can relax and enjoy coffee, pastries and conversation at the McCafé while their little ones frolic in the PlayPlace.

*right* Lunchtime at the Merivale McDonald's restaurant in Christchurch, New Zealand.





NOON





7:00 A.M.



*left* Early morning cleanup at the Wangfujing McDonald's restaurant in Beijing, China. *right* Quiet moments before people shopping for "treasures" arrive at Beijing's Lotus Flower Market.

## China

**IT'S 7:00 A.M.,** and our Wangfujing restaurant in Beijing is just opening for business. With cleanliness a hallmark of McDonald's, it's not unusual to find crewpeople cleaning the front steps of any debris that may have accumulated overnight, while others are busy preparing Chicken McNuggets and hamburgers for our morning customers. Although we do not serve a breakfast menu throughout China, we still rise early to serve up smiles and ring up sales. Ni hao!



**W**hen China reopened its doors to the Western world in 1992, McDonald's was already there.

In 1990, we introduced the McDonald's experience to the people of Mainland China with our first restaurant in Shenzhen, one of five special economic zones. Gradually, we expanded our presence, working with suppliers to establish an infrastructure that met our high-quality standards and could support future growth.

We now are enjoying the rewards of those investments. At year-end 2002, we operated more than 540 restaurants in 23 Chinese provinces, and we plan to significantly increase our presence over the next few years.

Our customer base encompasses people of all

ages, and it is common to find extended families — kids, parents, grandparents and great-grandparents — enjoying McDonald's meals. In addition to serving traditional favorites, such as Big Mac and McChicken sandwiches, we are appealing to

**we are appealing to local taste preferences with the popular Spicy Chicken Filet Burger and Spicy McWings**

local taste preferences with the popular Spicy Chicken Filet Burger and Spicy McWings.

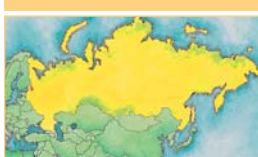
From a profitability perspective, our return on investment in China has risen from single digits in 1998 to low double digits in 2002. More importantly, we expect returns to increase further, as the standard of living in China continues to improve and we achieve additional economies of scale. Clearly, we are excited about the enormous potential for profitable growth in this country of 1.3 billion people.



*left* A Moscow street artist displays his talent. *right* Anytime is McDonald's time at the Serpukhovskaya Square McDonald's in Moscow, Russia.

## Russia

**IT'S 2:00 A.M.** in Moscow, and a customer is purchasing a meal at the McExpress walk-up window at the Serpukhovskaya Square McDonald's. The dining area of this restaurant closes at midnight, and there is no drive-thru. However, the 24-hour McExpress has proven to be a cost-efficient way of capturing sales, while providing added convenience for customers who are out and about at all hours in this high-traffic location.



In 1990, we broke our own record by serving more than 30,000 customers at the grand opening of the first McDonald's in what was then the Soviet Union.

What's more, our operations in Russia continue to hold records.

Today, that very same restaurant, located in Moscow's Pushkin Square, is the world's busiest McDonald's. Further, Russia ranked second in the average number of customers served per McDonald's restaurant in 2002. We attribute much of this popularity to our uncompromising commitment to quality, service, cleanliness and value.

Given the unique circumstances associated with doing business here in the early 1990s, we created a state-of-the-art food processing and distribution center, called McComplex, in Moscow. As a result, we were able to manage costs

while ensuring uninterrupted supplies of high-quality products. Over the years, we also forged strong relationships with more than 100 local suppliers. Currently, these

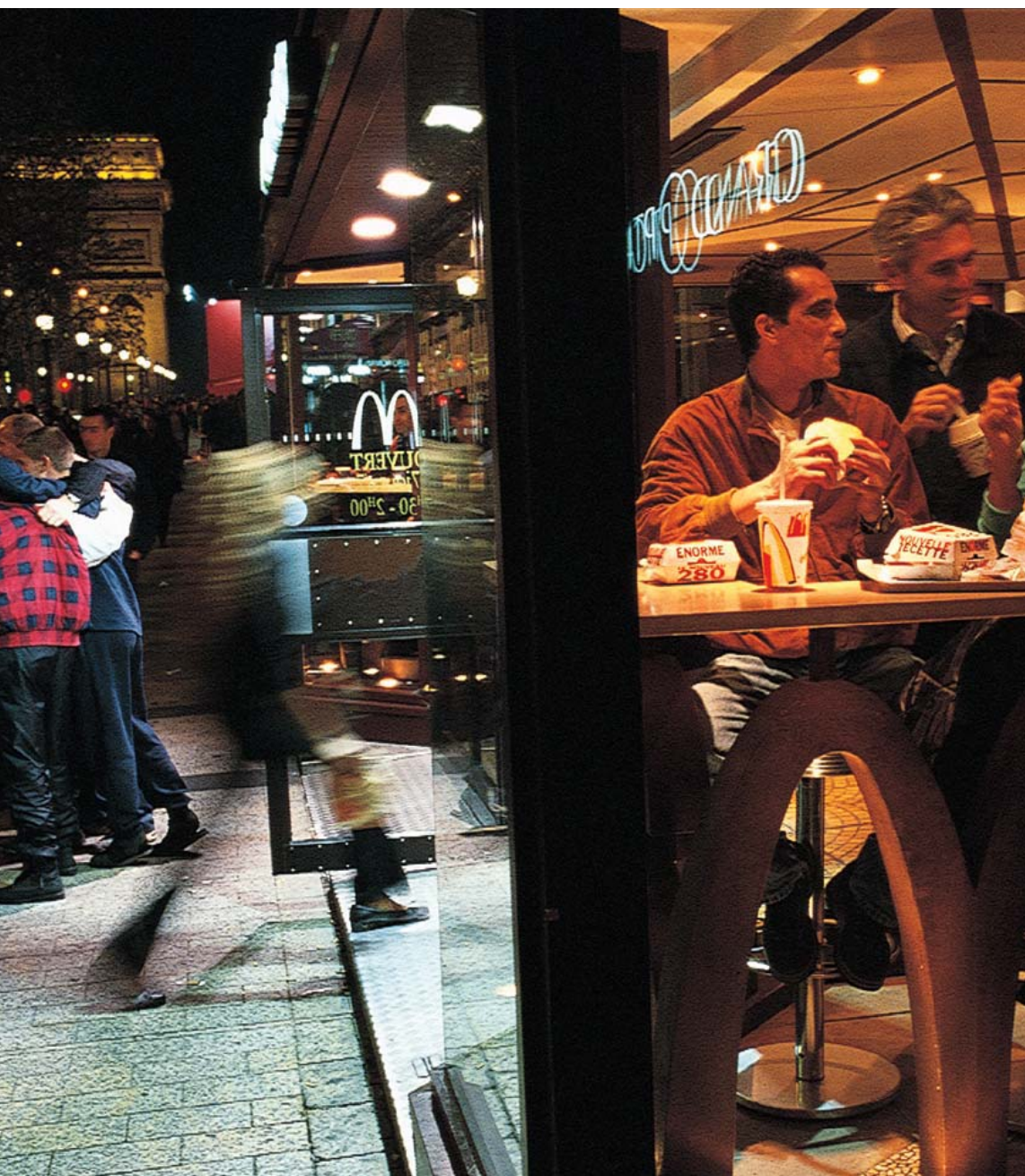
**during the next three to four years, we plan to add about 50 restaurants in Russia**

suppliers and our McComplex are meeting our growing needs in Russia. In fact, the

McComplex also exports ingredients to our operations in 18 other countries.

Today, we operate about 95 restaurants in 27 cities throughout Russia. As the country continues its transition to a free-market economy, its middle class continues to grow and demand for McDonald's is increasing. During the next three to four years, we plan to add about 50 restaurants in Russia. We will locate most of these in Moscow and St. Petersburg, highly populated cities of this country, where The Golden Arches are becoming a part of everyday life for many.





## France

**IT'S MIDNIGHT,** and the McDonald's located on the Champs-Élysées in Paris is alive with customers enjoying a late-night snack or a hearty meal during an evening out in this magnificent City of Lights. Clearly, the restaurant's spectacular location—

*just down the street from the breathtaking Arc de Triomphe—and its modern décor make it an ideal spot for tourists as well as Parisians.*



*above* A midnight “snack” at the Champs-Élysées McDonald's restaurant in Paris, France. *right* Paris' awe-inspiring Arc de Triomphe.







MIDNIGHT

Customers in France frequent local cafés and bistros as much for their ambience as for their food. As a result, these eateries are among our toughest competitors.

Identifying this as an opportunity rather than an obstacle, we embarked upon a strategy to make McDonald's more of a destination and are doing so by upgrading our décors and making our menu more relevant.

Many of our restaurants now feature comfortable, inviting décors that are better suited to the local environment. For example, many of those near sports stadiums have sports motifs, while those in the French Alps have a distinct chalet feel. We also have colorful, contemporary designs that add a touch of sophistication and individualization to

our interiors, yet are very welcoming to families. To date, we've employed eight new designs at more than a third of our 970 restaurants in France, and they are receiving rave reviews from customers and crew alike.

We also are making our menu more relevant to more people. We've added the

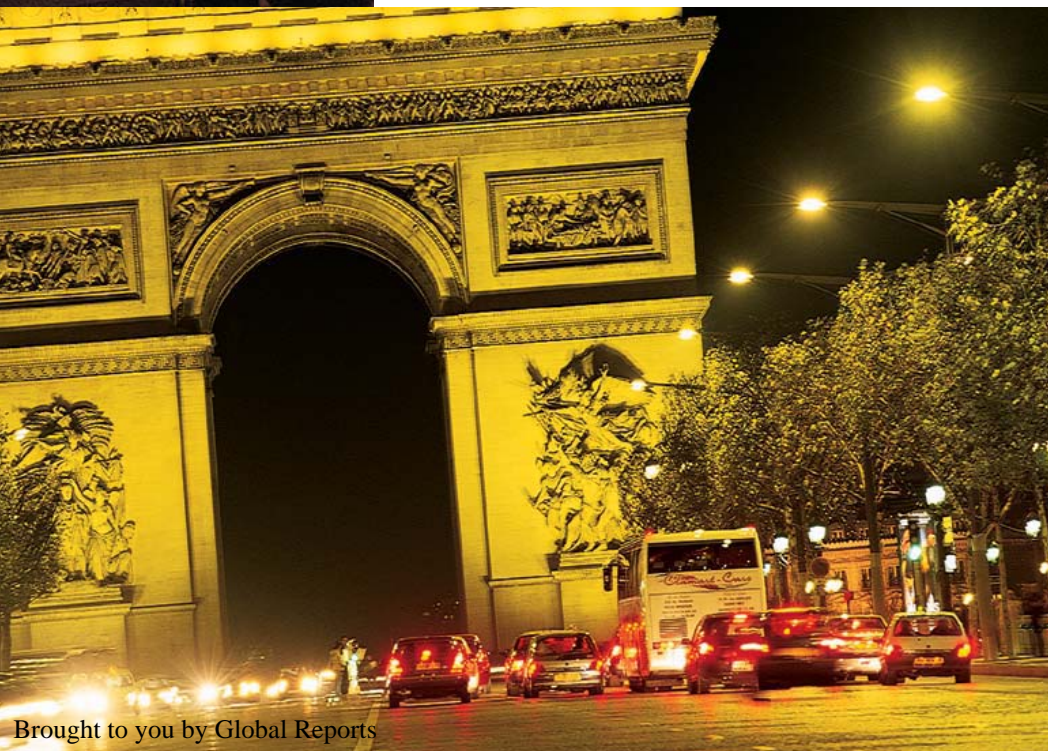
*we are making  
McDonald's a destination  
in France by upgrading  
our décors and making  
our menu more relevant*

Croque McDo ham and cheese sandwich and the hearty Le 280 beef sandwich to our

menu on a permanent basis. We even offer croissant breakfast sandwiches at some locations. We also continue to create food news with popular promotional offerings, such as the Chicken Country and the Chicken Premiere sandwich.

Clearly, our strategy is working. We have generated positive comparable sales and steady profit increases in France during each of the past six years.

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## United Kingdom

*IT'S 11:00 P.M., and the 24-hour McDonald's on Bath Road near London's Heathrow airport is busy as usual. There typically are a number of London's signature cabs in the drive-thru or parking lot, as many taxi drivers frequent this conveniently located restaurant. They know that they can rely on getting a tasty meal served quickly, at a good value—and possibly run into an old chum—between fares to and from the airport.*



**W**hen researching new ways to market Brand

McDonald's to a broad spectrum of customers in the U.K., we learned that while low prices are very important to some people, others place a high priority on large

sandwiches with special tastes.

We also learned that the folks in the latter group are willing to pay

a premium for these satisfying sandwiches. The common thread: people want choice and flexibility.

Based on these findings, we created a relevant three-tiered menu that showcases a variety of taste and price options in the U.K.

To start, we've retained our core menu, which features traditional favorites, such as our Egg McMuffin and Quarter Pounder with Cheese sandwiches, as well as our popular Extra Value Meals and Happy Meals. In fact, we are building on the success of our Happy Meals by broadening their appeal. Starting this April, kids and their parents will have more entrée and beverage choices, including Chicken Selects and no-sugar-added fruit drinks. In addition, for 59 pence, they will be able to add a dessert, such as slices of fresh fruit, to their Happy Meal.

*we created a relevant three-tiered menu that showcases a variety of taste and price options in the U.K.*

We also are attracting more price-sensitive consumers with our 99 Pence Menu, which features items including double cheese-burgers, fries and McFlurry desserts. Customers are using this menu to bundle their own meals, to satisfy their desire for a snack and

to make convenient add-on purchases. After the introduction of this affordable, flexible

menu, young adults told us that they are coming to McDonald's more often.

Finally, we are appealing to consumers who want larger sandwiches with premium offerings, such as the robust McChicken Premiere. This popular sandwich features a chicken breast filet topped with piquant salsa and a sour cream and chive sauce—all served on focaccia bread. Since its introduction in 2001, chicken sales as a percent of total sales have increased.

Clearly, our three-tiered menu is giving us a competitive edge in the U.K., as we gain recognition as a place for value, taste and variety.

*right* London's bustling Piccadilly Circus. *far right* A taxi driver stops for a late-night meal at the Bath Road McDonald's restaurant in Middlesex, England.





11:00 P.M.



Management  
speaks out  
about the key  
priorities that  
support the  
goal of being  
our customers'  
favorite place  
and way  
to eat.

#### "McDONALD'S

U.S.A. is focused on what matters most to our customers. With the support of our owner/operators, we intend to improve every customers' experience. We are working on five key priorities. These include improving *service* by focusing on the speed, accuracy and hospitality of our crew; improving the *taste* of our food while introducing compelling new product offerings; and *reimagining* some restaurants to create a more relevant dining experience. We also are providing greater *rewards and recognition* to our restaurant staffs and delivering *value leadership* with our Dollar Menu and strong local promotions."

MIKE ROBERTS  
President—U.S.A.

#### "OUR MISSION IS

to be Europe's favorite restaurant by providing consumers with an exceptional eating experience they can't get anywhere else. We intend to accomplish our mission through four key customer priorities. We will create a *hospitality culture* that delivers fast and friendly service to every customer, every visit. We will unveil exciting, new *food and beverage* offerings. We will expand our work on contemporary, relevant *restaurant décors and ambience* that make McDonald's a place to go to, not just pass through. And, we will continue to offer *the best value* for our customers' money and time through everyday affordability, innovation and a fun McDonald's experience."

RUSS SMYTH  
President—Europe





6:00 PM.  
BROADWAY and 42nd STREET  
MANHATTAN, NEW YORK



“IN ASIA/PACIFIC, the Middle East and Africa we are fortunate to be stewards of a brand that connects with the region’s customers and communities. Our brand remains strong despite the turbulent economic and political environment in some of the countries in which we operate. In 2003, our markets are focused on those things that make McDonald’s Brand strong and our restaurants the preferred eating-out choice—providing fast, friendly service; relevant food choices; a special treat for families with kids; and the best value.”

CLAIRE BABROWSKI  
*President—Asia/Pacific,  
Middle East and Africa*

“THE POSITIVE turnaround in Latin America sales during the second half of 2002 is a direct result of our relentless focus on everyday value. Results were strengthened by focusing our efforts on moms and kids and implementing a personalized service initiative that featured the return of hostesses. We plan to build on this momentum in 2003 while aggressively seeking margin improvements. In Canada, we will take similar actions starting with a strong focus on a branded value strategy augmented by service innovation at the front counter and drive thru.”

ED SANCHEZ  
*President—Latin America  
and Canada Group*

“CONSUMERS ARE looking for more ways to satisfy their need for food served at the pace of modern life. McDonald’s must use innovation in taste, experience and convenience to become more relevant to more people, more often. My priorities are first, to drive short-term results by more effective and efficient deployment of resources against higher return investments, both in real estate and innovation; and second, to fuel the engines of future growth with new food and new concepts that will leverage the vast infrastructure and capability of this phenomenal global network we simply call McDonald’s.”

MATS LEDERHAUSEN  
*President—Business  
Development*





6:00 P.M.

## United States

**IT'S 6:00 P.M.,** and the McDonald's on Broadway and 42nd Street in Manhattan is ready for the first curtain call of the evening. Tonight, Grilled Chicken Flatbread sandwiches headline a cast of great-tasting products.

This one-of-a-kind McDonald's is well suited to the area that is home to New York City's world-renowned Broadway Theater District. It also has been a box-office hit in its own right since its standing-room-only premiere in September of 2002.

The brilliant marquee beckons city dwellers and visitors to the restaurant, while the backstage-inspired interior and top-notch service make all who enter feel like stars.



*far left* Dinner at the Broadway and 42nd Street McDonald's restaurant in Manhattan, New York. *left* Perpetual motion typifies New York City's Times Square.

**T**here are more than 13,000 McDonald's across the U.S., and our goal is to increase the sales, profits and cash flows of these restaurants. But unless we improve

our operations, nothing else we do will matter.

The reality is our customers want and deserve

better overall experiences, and we have recommitted ourselves to getting the basics right—every customer, every time.

An important first step is our restaurant operations improvement process, which is designed to raise the levels of quality, service and cleanliness at all U.S. McDonald's. One component of this restaurant training and measurement tool is our mystery shopper program.

Under this restaurant-specific program, independent evaluators rate numerous aspects of their McDonald's experience—all from a customer's perspective. This allows us to identify the strengths and weaknesses of each restaurant and to tailor meaningful plans for improvement. During 2002, more than 183,500 mystery shops were conducted, and our scores show we have made some progress.

For example, we know that customers who are looking for fast service often choose McDonald's and that optimum staffing during busy periods often translates to increased sales. So, we have a renewed focus on

properly staffing our restaurants during the peak hours of 11 a.m. to 1 p.m.

Notably, our fast-service rating from last year's mystery shops showed the greatest improvement during this important peak-lunch period.

We also know that customers look to us for convenience. So, we embarked on an extended-hour initiative at our U.S. Company-operated restaurants. These new, later hours are having an impact, as evidenced by the double-digit sales increase generated after 9:00 p.m. by these restaurants in 2002.

The results of these initiatives demonstrate that we have begun to make a positive difference in our customers' experiences. Yet, we have a lot more to do. We will continue to focus on those things that our customers want most: great-tasting food, top-notch service and clean, welcoming restaurant environments.

**we embarked on an extended-hour initiative at our U.S. Company-operated restaurants**



## Mexico

**IT'S 5:00 P.M.,** and a family is enjoying an early dinner, complete with Happy Meals for the kids, at the Tollocan McDonald's in Toluca. Other youngsters are having fun in the McDonalandia, a test play space with a variety of activities for children of all ages. Families are a very important part of our business in Mexico. In fact, Happy Meal transactions in Mexico are among the highest in the world, as extended families visit our restaurants for affordable, satisfying meals.



**M**exico is among our more promising markets in Latin America. However, it wasn't long ago that we turned an economic challenge in that country into a sales- and profit-building opportunity.

The devaluation of the Mexican peso in late 1994 had an immediate and dramatic effect throughout the country. With the resulting decreases in disposable income, our sales and profits in Mexico declined sharply.

So, we reinvented the way we do business. For example, we began selling cones at an exceptional value so that a family visit to McDonald's was still affordable. We drove down costs by working with existing suppliers to create new efficiencies. We also significantly limited our exposure to outside currencies by developing new local suppliers. In

addition, as appropriate, we renegotiated leases with landlords to better reflect the economic environment in which we were operating.

As the economy and our business started to improve, we introduced a breakfast menu to build sales and transactions. We appealed to local taste preferences with

egg offerings featuring jalapeño peppers and refried beans — locally

grown ingredients that further protected profits from swings in foreign currency exchange rates.

Although 1995 was a difficult year, our efforts paid off. During the following four years, our comparable sales increases in Mexico averaged more than 20 percent. Today, we are sharing the learnings from our experience in Mexico with our people in other countries with local economic challenges.

***we are sharing  
the learnings from  
our experience in Mexico  
with our people  
in other countries***



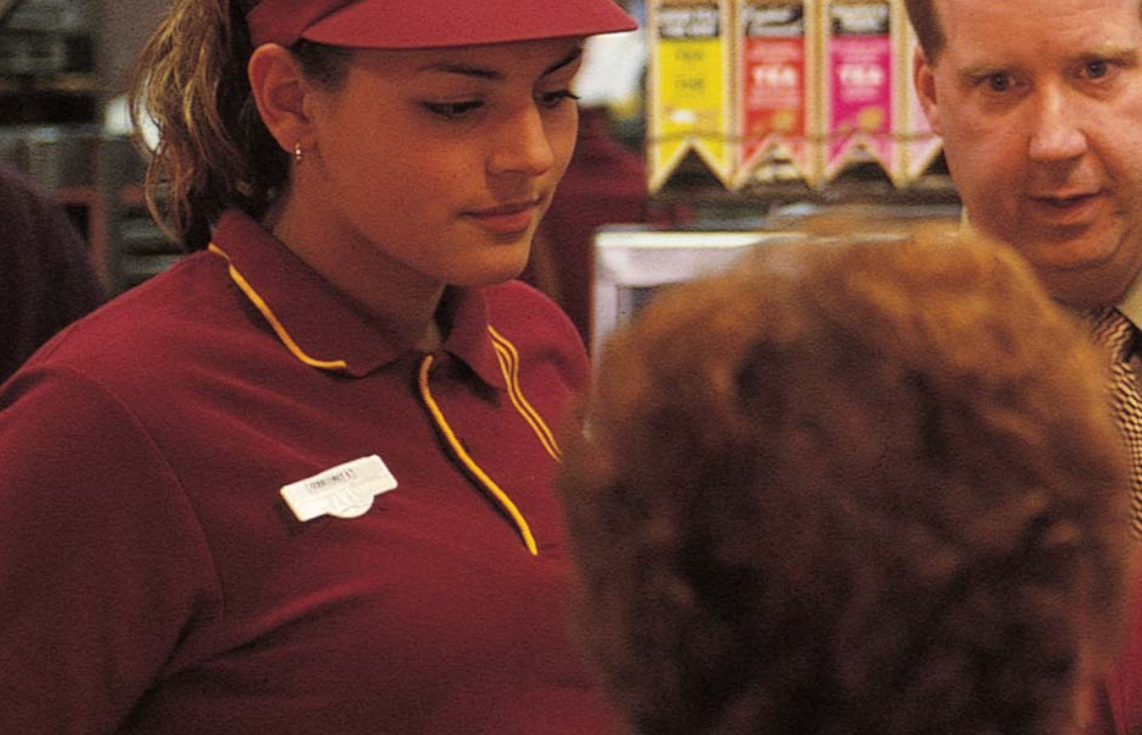




*above* An early family dinner at the Tollocan McDonald's restaurant in Toluca, Mexico.  
*left* The regal Pyramid of the Moon (circa 200 A.D.) in Teotihuacan, Mexico.







*above* Shoulder-to-shoulder coaching at the McDonald's restaurant in Maple Ridge, British Columbia. *below* Totem poles adorn the Canadian Rockies.





## Canada

**IT'S 3:00 P.M.,** and the manager of the McDonald's on Lougheed Highway in Maple Ridge is coaching his crew at the front counter to ensure they have the tools necessary to deliver premier customer service. We know that proper training is critical to both job satisfaction and to wowing our customers. Our goal is to increasingly use technology to relieve managers of many of their administrative tasks so they can spend more time with their customers and crews.



**O**ur strategy in Canada is to build brand loyalty by enhancing the convenience, variety and value we offer.

We are making McDonald's more convenient by offering 24-hour drive-thru service at virtually all traditional Company-operated restaurants in Canada. Further, almost all of our franchised restaurants with drive-thrus will offer this service during the coming summer. We believe people on the go will like the added hours, as evidenced by the sales generated between midnight and 6:00 a.m. at our restaurants in Quebec and Atlantic Canada that offered this service throughout 2002.

We also are giving customers more choices and responding to changing eating habits with our Lighter Choices Menu.

These delicious offerings include our McVeggie Burger and Whole Wheat Chicken McGrill sandwiches, fresh salads and Fruit 'n Yogurt Parfaits. Notably, many moms now are enjoying one of our Lighter Choices selections while their children enjoy their Happy Meals. As awareness for this new menu category continues to build, we expect more customers will think of McDonald's as a

place for lighter alternatives.

In addition, we are adding interest to our great everyday

values by featuring a popular McDonald's entrée each day of the week at a special price. We are using these rotating daily specials to reward regular customers, build visit frequency and attract new customers.

Brand loyalty must be earned, and we will continue to find new ways to make it easier for people in Canada to choose McDonald's.

**we are offering 24-hour drive-thru service at virtually all traditional Company-operated restaurants in Canada**

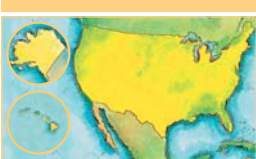




Palm trees and blue skies add to the serenity that defines Hawaii.

## United States

**IT'S 1:00 P.M.,** an hour when even Hawaii's most ardent surfers break for lunch. Luckily, the McDonald's restaurant on Kalakaua Avenue is just across the street from Honolulu's famous Waikiki Beach, better known as Kuhio Beach among the locals. The awesome waves make this beach a popular surfing destination, while our variety and great values make McDonald's a popular destination for those enjoying a day of fun and sun in this tropical paradise.



**P**roviding exceptional values to customers has always been a hallmark of Brand McDonald's. And, we've been busy freshening up our value proposition across the U.S.

On the price front, we introduced the Dollar Menu nationally late last year. Customers are using this menu — which features a selection of great tastes priced at \$1 — to build their own meals, to add an item to their Extra Value Meals or simply to grab snacks.

In addition, we are keeping our U.S. menu contemporary with McDonald's Taste Sensations, which include limited-time product offerings, such as the popular Chicken Flatbread, as well as exciting new permanent menu additions, such

**we are keeping our U.S. menu contemporary with McDonald's Taste Sensations**

as our line of delicious premium salads. We currently are rolling out fresh Caesar, California Cobb and Bacon Ranch salads, topped with slices of warm, juicy grilled or crispy chicken breast meat. Customers who prefer can even order their McDonald's salads without chicken.

Comfortable, inviting, distinctive restaurants also add to the value of the overall McDonald's experience. So we and our owner/operators are investing in existing restaurants, concentrating on those that will benefit most from the enhancements. Some will be remodeled, while others will be either rebuilt or relocated.

Enhancements will range from adding amenities, such as self-service beverage bars, to adding double-lane drive-thrus to speed service.

Our objective is simple: to make McDonald's a more compelling choice for customers, in turn driving increases in sales and generating good returns for the Company, our owner/operators and our shareholders.

*right* Lunchtime at Kuhio Beach, across from the Kalakaua McDonald's restaurant in Honolulu, Hawaii.





November 20, 2002

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Childhood should be filled with laughs, hugs and the creation of joyful memories. It's a time when anything and everything should be considered possible—a time when “ev’ry boy and girl should dance on dreams.”

However, for many children such a childhood does not exist.

That’s why McDonald’s created **World Children’s Day**, a day marked by an historic fundraising initiative benefiting the well being of children desperately in need of assistance. The date selected for World Children’s Day, November 20, 2002, coincided with the 13th anniversary of the United Nations’ adoption of the Convention on the Rights of the Child.

On this day, more than \$12 million was raised for Ronald McDonald House Charities and children’s causes worldwide as McDonald’s restaurants in more than 100 countries united with customers to help children in need. The funds are being used in a multitude of ways. For example, assistance is being provided to orphanages in Russia, Estonia and Kuwait, as well as to children’s hospitals and children’s health organizations around the world. Also, some of the funds are being used to help support 16 new Ronald McDonald Houses in seven European and two Latin American countries.

Consistent with our long history of caring for kids, the events surrounding World Children’s Day raised awareness of the ever-increasing needs of children and the important role we all can, and must, play to affect positive change in our communities around the world.

The day was kicked off with a sunrise celebration at the Auckland Ronald McDonald House in New Zealand, the first country to officially welcome the dawn of World Children’s Day and concluded 41 hours later as the sun set in Western Samoa. Activities varied by country and market, ranging from donations of product and restaurant sales to children’s concerts and festivals to the distribution of critical services and supplies to families and children in need.

This unprecedented global event resulted from the efforts of many extraordinary people, most notably the millions of McDonald’s customers and local celebrities who participated in the many fundraising activities.

We also owe very special thanks to the recording artists who raised their voices in a U.S. network telecast of the “Concert for World Children’s Day.” This special featured a star-studded lineup including Celine Dion, Enrique Iglesias, Josh Groban and Nick Carter, formerly of the Backstreet Boys. The concert also aired in Canada, Finland, Russia and the Netherlands.

In connection with this concert, Grammy award-winning composer, producer and writer David Foster and his wife, lyricist Linda Thompson, created a song dedicated to the less fortunate children of the world. Entitled “Aren’t They All Our Children,” the lyrics aptly remind us that “Ev’ry boy and girl should dance on dreams around this world. Aren’t they all our children after all?”

We hope that because of the many people who gave so selflessly on World Children’s Day a few more children will be able to “dance on dreams.”

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play to affect  
positive change in our  
communities  
around the world*



*McDonald's Corporate Officers not included in the above photos appear elsewhere in this report. Not featured is Henry Gonzalez.*

*top, left to right Lynn Crump-Caine, Tom Ryan, Dave Pojman and Matthew Paull  
middle, left to right Stan Stein, Jan Fields, Gloria Santona and Ralph Alvarez  
bottom, left to right Marvin Whaley, Don Thompson and Larry Light*

*As of February 3, 2003*

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Edward Brennan  
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**Corporate Controller**

David Pojman

**General Counsel and  
Corporate Secretary**

Gloria Santona

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**32 Account inquiries and transactions**

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March 29  
NAIC Fair, Orlando FL

June 27-29  
NAIC Compufest 2003,  
Anaheim CA

**Stock exchange listings**

New York, Chicago, Euronext  
Paris, German and Swiss

**Trading symbol**

MCD

**Annual meeting**

May 22, 2003  
9:00 a.m. Central Time  
The Lodge  
McDonald's Office Campus  
Oak Brook IL 60523  
  
Live webcast available on  
[www.investor.mcdonalds.com](http://www.investor.mcdonalds.com)

**Website**

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**McDonald's social responsibility report**

[www.mcdonalds.com/corporate/social](http://www.mcdonalds.com/corporate/social)

**Home office**

McDonald's Corporation  
McDonald's Plaza  
Oak Brook IL 60523

*The information in this report is as of  
December 31, 2002 unless otherwise  
indicated.*

**Forward-looking statements**

Certain forward-looking statements are included in this report. They use such words as "may," "will," "expect," "believe," "plan" and other similar terminology. These statements reflect management's current expectations regarding future events and operating performance and speak only as of March 21, 2003. These forward-looking statements involve a number of risks and uncertainties. The following are some of the factors that could cause actual results to differ materially from those expressed in or underlying our forward-looking statements: effectiveness of operating initiatives; success in advertising and promotional efforts; changes in global and local business and economic conditions, including their impact on consumer confidence; fluctuations in currency exchange and interest rates; food, labor and other operating costs; political or economic instability in local markets, including the effects of war and terrorist activities; competition, including pricing and marketing initiatives and new product offerings by the Company's competitors; consumer preferences or perceptions concerning the Company's product offerings; spending patterns and demographic trends; availability of qualified restaurant personnel; severe weather conditions; existence of positive or negative publicity regarding the Company or its industry generally; effects of legal claims; cost and deployment of capital; changes in future effective tax rates; changes in governmental regulations; and changes in applicable accounting policies and practices. The foregoing list of important factors is not all inclusive.

The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

The following trademarks used herein are the property of McDonald's Corporation and its affiliates: 1-800-Mc1-STCK; Big Mac; Big Red French Fry Box Design; Chicken McGrill; Chicken McNuggets; Croque McDo; Egg McMuffin; Extra Value Meal; The Golden Arches; Golden Arches Logo; Happy Meal; Made For You; Mai Don Lao; McCafé; McChicken; MCDirect Shares; McDonaldland; McDonaldlandia; McDonald's; McExpress; McFlurry; McPatatas; McVeggie; PlayPlace; Quarter Pounder; Ronald McDonald; Ronald McDonald House; Ronald McDonald House Charities; Spicy McWings; World Children's Day; World Famous Fries; [www.mcdonalds.com](http://www.mcdonalds.com)

Product names and descriptions are country specific and may not be applicable worldwide. Prices and marketing initiatives pertain only to participating restaurants.

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The McDonald's photos on pages 6-27 were shot on or about the time indicated in the copy. Although the photos were not taken at the exact same moment, they do represent a typical moment in time around the world at McDonaldland.

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McD 03-4232



# McDonald's New Premium Salads

McDonald's restaurants across the U.S. are introducing customers to a lineup of exciting, new salads:

## Caesar, California Cobb and Bacon Ranch

Our delicious salads are made with blends of crisp, garden fresh vegetables and topped with cheese and a choice of sliced warm, juicy crispy or grilled chicken breast meat. For those who prefer, these great-tasting salads also are available without chicken!

These new premium salads are adding variety to our U.S. menu and are giving more customers more reasons to visit McDonald's.

We will make McDonald's  
the Brand people grow up with  
...and never outgrow.

We intend to remain  
constantly relevant  
in a constantly changing world.

**McDONALD'S**  
Yesterday, Today and Tomorrow





2002  
McDONALD'S CORPORATION  
Financial Report



## 11-year summary

McDonald's Corporation 1

DOLLARS IN MILLIONS,  
EXCEPT PER SHARE DATA

	2002	2001	2000	1999	1998	1997	1996	1995	1994	1993	1992
<b>Total revenues</b>	<b>\$15,406</b>	14,870	14,243	13,259	12,421	11,409	10,687	9,795	8,321	7,408	7,133
<b>Operating income</b>	<b>\$ 2,113<sup>(1)</sup></b>	2,697 <sup>(2)</sup>	3,330	3,320	2,762 <sup>(3)</sup>	2,808	2,633	2,601	2,241	1,984	1,862
<b>Income before taxes and cumulative effect of accounting change</b>	<b>\$ 1,662<sup>(1)</sup></b>	2,330 <sup>(4)</sup>	2,882	2,884	2,307 <sup>(3)</sup>	2,407	2,251	2,169	1,887	1,676	1,448
<b>Net income</b>	<b>\$ 893<sup>(1,5)</sup></b>	1,637 <sup>(4)</sup>	1,977	1,948	1,550 <sup>(3)</sup>	1,642	1,573	1,427	1,224	1,083	959
<b>Cash provided by operations</b>	<b>\$ 2,890</b>	2,688	2,751	3,009	2,766	2,442	2,461	2,296	1,926	1,680	1,426
<b>Capital expenditures</b>	<b>\$ 2,004</b>	1,906	1,945	1,868	1,879	2,111	2,375	2,064	1,539	1,317	1,087
<b>Treasury stock purchases</b>	<b>\$ 687</b>	1,090	2,002	933	1,162	765	605	321	500	628	92
<b>Financial position at year end:</b>											
Total assets	<b>\$23,971</b>	22,535	21,684	20,983	19,784	18,242	17,386	15,415	13,592	12,035	11,681
Total debt	<b>\$ 9,979</b>	8,918	8,474	7,252	7,043	6,463	5,523	4,836	4,351	3,713	3,857
Total shareholders' equity	<b>\$10,281</b>	9,488	9,204	9,639	9,465	8,852	8,718	7,861	6,885	6,274	5,892
Shares outstanding IN MILLIONS	<b>1,268</b>	1,281	1,305	1,351	1,356	1,371	1,389	1,400	1,387	1,415	1,454
<b>Per common share:</b>											
Net income—basic <sup>(5)</sup>	<b>\$ .70<sup>(1)</sup></b>	1.27 <sup>(4)</sup>	1.49	1.44	1.14 <sup>(3)</sup>	1.17	1.11	.99	.84	.73	.65
Net income—diluted <sup>(5)</sup>	<b>\$ .70<sup>(1)</sup></b>	1.25 <sup>(4)</sup>	1.46	1.39	1.10 <sup>(3)</sup>	1.15	1.08	.97	.82	.71	.63
Dividends declared	<b>\$ .24</b>	.23	.22	.20	.18	.16	.15	.13	.12	.11	.10
Market price at year end	<b>\$ 16.08</b>	26.47	34.00	40.31	38.41	23.88	22.69	22.56	14.63	14.25	12.19
Franchised sales	<b>\$25,692</b>	24,838	24,463	23,830	22,330	20,863	19,969	19,123	17,146	15,756	14,474
Company-operated sales	<b>\$11,500</b>	11,040	10,467	9,512	8,895	8,136	7,571	6,863	5,793	5,157	5,103
Affiliated sales	<b>\$ 4,334</b>	4,752	5,251	5,149	4,754	4,639	4,272	3,928	3,048	2,674	2,308
<b>Total Systemwide sales<sup>(6)</sup></b>	<b>\$41,526</b>	40,630	40,181	38,491	35,979	33,638	31,812	29,914	25,987	23,587	21,885
Franchised restaurants	<b>17,864</b>	17,395	16,795	15,949	15,086	14,197	13,374	12,186	10,944	9,918	9,237
Company-operated restaurants	<b>9,000</b>	8,378	7,652	6,059	5,433	4,887	4,294	3,783	3,216	2,733	2,551
Affiliated restaurants	<b>4,244</b>	4,320	4,260	4,301	3,994	3,844	3,216	2,330	1,739	1,476	1,305
<b>Total Systemwide restaurants<sup>(7)</sup></b>	<b>31,108</b>	30,093	28,707	26,309	24,513	22,928	20,884	18,299	15,899	14,127	13,093

(1) Includes pretax operating charges of \$853 million (\$700 million after tax or \$0.55 per share) primarily related to restructuring markets and eliminating positions, restaurant closings/asset impairment and the write-off of technology costs. (The cash portion of this pretax expense was approximately \$100 million after tax.) See page 2 for further details.

(2) Includes \$378 million of pretax operating charges primarily related to the U.S. business reorganization and other global change initiatives, and restaurant closing/asset impairment charges discussed on page 2.

(3) Includes pretax operating charges of \$322 million (\$219 million after tax or \$0.16 per share) consisting of \$162 million of Made For You costs and the \$160 million charge related to the home office productivity initiative.

(4) Includes a net pretax expense of \$253 million (\$143 million after tax or \$0.11 per share) consisting of \$378 million of pretax operating charges noted in (2) above and \$125 million of net pretax nonoperating income primarily related to a gain on the initial public offering of McDonald's Japan. (The cash portion of this net pretax expense was approximately \$100 million after tax.) See page 2 for further details. Net income also reflects an effective tax rate of 29.8 percent, primarily due to the benefit of tax law changes in certain international markets (\$147 million).

(5) In 2002, includes a \$98.6 million after-tax charge (\$0.08 per share—basic and \$0.07 per share—diluted) to reflect the cumulative effect of the adoption of SFAS No. 142, Goodwill and Other Intangible Assets, which eliminates the amortization of goodwill and instead subjects it to annual impairment tests. See page 10 for further discussion. Net income per share, adjusted for the nonamortization provisions of SFAS No. 142, would have been \$0.02 higher than the amount reported for 2001 and 2000 and \$0.01 higher for 1996–1999.

(6) Systemwide sales include sales by all restaurants, whether operated by the Company, by franchisees or by affiliates operating under joint-venture agreements. See page 4 for further discussion.

(7) See page 10 for detail of Systemwide restaurants by geographic segment and Partner Brand.

## Management's discussion and analysis of financial condition and results of operations

### NATURE OF BUSINESS

The Company operates in the food service industry and primarily operates and franchises quick-service restaurant businesses under the McDonald's brand (McDonald's restaurants). Approximately 80% of McDonald's restaurants and about 75% of the total revenues of McDonald's restaurants are in nine markets: Australia, Brazil, Canada, China, France, Germany, Japan (a 50%-owned affiliate accounted for under

the equity method), the United Kingdom and the United States. Throughout this discussion, McDonald's restaurant businesses in these nine markets collectively are referred to as "major markets."

The Company also operates other restaurant concepts under its Partner Brands: Boston Market, Chipotle Mexican Grill and Donatos Pizzeria. In addition, the Company has a minority ownership in Pret A Manger. In March 2002, the Company sold its Aroma Café business in the U.K.

### CONSOLIDATED OPERATING RESULTS

#### Operating results

DOLLARS IN MILLIONS.  
EXCEPT PER SHARE DATA

	2002		2001		2000
	Amount	Increase/(decrease)	Amount	Increase/(decrease)	Amount
<b>Revenues</b>					
Sales by Company-operated restaurants	\$11,500	4 %	\$11,041	5 %	\$10,467
Revenues from franchised and affiliated restaurants	3,906	2	3,829	1	3,776
<b>Total revenues</b>	<b>15,406</b>	<b>4</b>	<b>14,870</b>	<b>4</b>	<b>14,243</b>
<b>Operating costs and expenses</b>					
Company-operated restaurants	9,907	5	9,454	8	8,750
Franchised restaurants	840	5	800	4	772
Selling, general & administrative expenses	1,713	3	1,662	5	1,587
Other operating (income) expense, net	833	nm	257	nm	(196)
<b>Total operating costs and expenses</b>	<b>13,293</b>	<b>9</b>	<b>12,173</b>	<b>12</b>	<b>10,913</b>
<b>Operating income</b>	<b>2,113</b>	<b>(22)</b>	<b>2,697</b>	<b>(19)</b>	<b>3,330</b>
Interest expense	374	(17)	452	5	430
McDonald's Japan IPO gain		nm	(137)	nm	
Nonoperating expense, net	77	48	52	nm	18
<b>Income before provision for income taxes and cumulative effect of accounting change</b>	<b>1,662</b>	<b>(29)</b>	<b>2,330</b>	<b>(19)</b>	<b>2,882</b>
Provision for income taxes	670	(3)	693	(23)	905
<b>Income before cumulative effect of accounting change</b>	<b>992</b>	<b>(39)</b>	<b>1,637</b>	<b>(17)</b>	<b>1,977</b>
Cumulative effect of accounting change, net of tax	(99)	nm			
<b>Net income</b>	<b>\$ 893</b>	<b>(45)%</b>	<b>\$ 1,637</b>	<b>(17)%</b>	<b>\$ 1,977</b>
<b>Per common share—diluted:</b>					
<b>Income before cumulative effect of accounting change</b>	<b>\$ .77</b>	<b>(38)%</b>	<b>\$ 1.25</b>	<b>(14)%</b>	<b>\$ 1.46</b>
Cumulative effect of accounting change	(.07)	nm			
<b>Net income</b>	<b>\$ .70</b>	<b>(44)%</b>	<b>\$ 1.25</b>	<b>(14)%</b>	<b>\$ 1.46</b>

nm Not meaningful.

#### STRATEGIC ACTIONS

In 2002, the Company initiated several strategic actions designed to optimize existing restaurant operations and improve the business. These actions were consistent with management's strategy of concentrating its capital and resources on the best near-term opportunities and of avoiding those that distract from restaurant-level execution. They included the restructuring of certain markets, the closing of a significant number of underperforming restaurants, the decision to terminate a long-term technology project, and the consolidation of certain home office facilities and elimination of positions to control costs, streamline operations and reallocate resources.

In 2001, the Company implemented strategic changes and restaurant initiatives in the U.S. and certain international markets. The changes in the U.S. included streamlining operations by reducing the number of regions and divisions, enabling the Company to combine staff functions and improve efficiency.

The Company recorded charges and/or gains associated with these actions in 2002 and 2001 as "significant items." Significant items generally represent charges and/or gains for actions or transactions related to the implementation of special initiatives of the Company or items that are unusual or infrequent in nature. The Company does not include these items when reviewing business performance trends,



because management does not believe these are indicative of ongoing operations.

The Company recorded \$853 million of significant items in 2002 and \$253 million of significant items in 2001. All significant items for both years were recorded in other operating expense, except as noted in the discussion that follows.

Significant items — expense/(income)						
DOLLARS IN MILLIONS	Pretax		After tax		Per common share-diluted	
	2002	2001	2002	2001	2002	2001
Restructuring charges	\$267	\$200	\$244	\$136	\$ .19	\$ .11
Restaurant closings/ asset impairment	402	135	336	107	.26	.08
Technology write-offs and other charges	184	55	120	37	.10	.03
McDonald's Japan IPO gain		(137)		(137)		(.11)
Total significant items <sup>(1)</sup>	\$853	\$253	\$700	\$143	\$ .55	\$ .11

(1) See other operating (income) expense, net note to consolidated financial statements on page 24 for a summary of the activity in the related liabilities.

#### *Restructuring charges—restructuring markets and eliminating positions*

In 2002, the Company recorded \$267 million of pretax charges related to transferring ownership in four countries in the Middle East and Latin America to developmental licensees (approximately 150 restaurants), ceasing operations in three countries in Latin America (approximately 20 restaurants), and eliminating positions (approximately 600 positions, about half of which were in the U.S. and half of which were in international markets), reallocating resources and consolidating certain home office facilities to control costs. Under the developmental license business structure, which the Company successfully employs in more than 25 markets outside the U.S. (approximately 350 restaurants), the licensee owns the business, including the real estate interest. While the Company generally does not have any capital invested in these markets, it receives a royalty based on a percent of sales.

The 2002 restructuring charges consisted of: \$136 million of asset write-offs and losses on the sale of assets and \$65 million of costs for leases and other obligations in the markets restructured or exited, \$56 million of severance and other employee-related costs, \$15 million of lease cancellation and other costs related to the closing of certain home office facilities, and \$10 million of payments made to facilitate a change of ownership from U.S. franchisees who have had a history of financial difficulty and consequently were unable to deliver the level of operational excellence needed to succeed in the future. These changes were partially offset by a \$15 million reversal of accrued restructuring costs recorded in 2001, primarily due to lower employee-related costs than originally estimated.

In 2001, the Company recorded \$200 million of pretax restructuring charges related to the strategic changes and restaurant initiatives in the U.S. and certain international markets. The initiatives were designed to improve the restaurant experience and included accelerated operations training, restaurant simplification, incentives for outstanding restaurant

operations and an enhanced national restaurant evaluation system. In connection with these initiatives, the Company eliminated approximately 850 positions, consisting of 700 positions in the U.S., primarily in the divisions and regions, and 150 positions in international markets.

The 2001 restructuring charges consisted of: \$114 million of severance and other employee-related costs, \$69 million of lease cancellation and other costs related to the closing of region and division facilities, and \$17 million of other cash costs, primarily consisting of payments made to facilitate a change of ownership from U.S. franchisees who have had a history of financial difficulty and consequently were unable to deliver the level of operational excellence needed to succeed in the future.

#### *Restaurant closings/asset impairment*

In 2002, the Company recorded \$402 million of pretax charges consisting of: \$302 million related to management's decision to close 751 underperforming restaurants (234 were closed in 2002 and 517 will close throughout 2003) primarily in the U.S. and Japan, and \$100 million primarily related to the impairment of assets for certain existing restaurants in Europe and Latin America. Most of the restaurants identified for closing had negative cash flows and/or very low annual sales volumes. Also, in many cases they would have required significant capital investment over the next several years to remain financially viable.

In 2001, the Company recorded \$135 million of pretax charges consisting of: \$91 million related to the closing of 163 underperforming restaurants in international markets in 2001, a \$24 million asset impairment charge due to an assessment of the ongoing impact of Turkey's significant currency devaluation on our business, and \$20 million related to the disposition of Aroma Café in the U.K.

Although restaurant closings occur each year, these 2002 and 2001 restaurant closing charges are identified as "significant items" because they were the result of separate intensive reviews by management in conjunction with other strategic actions.

#### *Technology write-offs and other charges*

In 2002, the Company recorded \$184 million of pretax charges consisting of: \$170 million primarily related to the write-off of software development costs as a result of management's decision to terminate a long-term technology project, and \$14 million primarily related to the write-off of receivables and inventory in Venezuela as a result of the temporary closure of all McDonald's restaurants due to the national strike that began in early December. Although the terminated technology project was projected to deliver long-term benefits, it was no longer viewed as the best use of capital in the current environment, as the anticipated Systemwide cost over several years was expected to be in excess of \$1 billion.

In 2001, the Company recorded \$55 million of pretax charges consisting of: \$18 million primarily related to the write-off of certain technology, \$12 million (recorded in nonoperating expense) primarily related to the write-off of a corporate investment, and \$25 million primarily related to

the unrecoverable costs incurred in connection with the theft of winning game pieces from the Company's Monopoly and certain other promotional games over an extended period of time, and the related termination of the supplier of the game pieces. Fifty individuals (none of whom were Company employees) were convicted of conspiracy and/or mail fraud charges.

#### *McDonald's Japan IPO gain*

In 2001, McDonald's Japan, the Company's largest market in the Asia/Pacific, Middle East and Africa (APMEA) segment, completed an IPO of 12 million shares. The Company owns 50% of McDonald's Japan, while the Company's founding partner Den Fujita and his family own approximately 26%. The Company recorded a \$137 million gain (pre and after tax) in nonoperating income to reflect an increase in the carrying value of its investment as a result of the cash proceeds from the IPO received by McDonald's Japan.

**EFFECT OF FOREIGN CURRENCIES ON REPORTED RESULTS**  
While changing foreign currencies affect reported results, McDonald's lessens exposures, where practical, by financing in local currencies, hedging certain foreign-denominated cash flows and by purchasing goods and services in local currencies.

#### **Effect of foreign currency translation on consolidated reported results — positive/(negative)**

DOLLARS IN MILLIONS, EXCEPT PER SHARE DATA	2002	2001	2000
Revenues	\$15	\$(457)	\$(594)
Operating income	90	(78)	(151)
Net income	42	(50)	(92)
Net income per common share—diluted	.04	(.04)	(.07)

In 2002, foreign currency translation had a minimal impact on the revenue growth rate as the stronger Euro and British Pound were offset by weaker Latin American currencies (primarily the Argentine Peso, Brazilian Real and Venezuelan Bolivar). The operating income growth rate for 2002 was positively impacted by foreign currency translation primarily due to the stronger Euro and British Pound. In 2001, foreign currency translation had a negative impact on the growth rates primarily due to the weaker Euro, British Pound, Australian Dollar, Japanese Yen and Canadian Dollar.

All information presented in constant currencies excludes the effect of foreign currency translation on reported results except for hyperinflationary economies, whose functional currency is the U.S. Dollar. Constant currency results are calculated by translating the current year results at prior year average exchange rates.

#### **SYSTEMWIDE SALES**

Systemwide sales include sales by all restaurants, whether operated by the Company, by franchisees or by affiliates operating under joint-venture agreements. Management believes that Systemwide sales information is useful in analyzing the Company's revenues because franchisees and affiliates pay rent, service fees and/or royalties that generally are based on a percent of sales with specified minimum payments.

#### **Systemwide sales**

DOLLARS IN MILLIONS	2002			2001			2000 As reported amount
	As reported amount	Increase/(decrease) As reported amount	Constant currency <sup>(1)</sup>	As reported amount	Increase/(decrease) As reported amount	Constant currency <sup>(1)</sup>	
U.S.	\$20,306	1%	na	\$20,051	2%	na	\$19,573
Europe	10,476	11	5%	9,412	1	5%	9,293
APMEA	6,776	(3)	(3)	7,010	(6)	3	7,477
Latin America	1,444	(17)	4	1,733	(3)	6	1,790
Canada	1,456	1	2	1,447	—	5	1,443
Partner Brands	1,068	9	9	977	61	62	605
Total	\$41,526	2%	2%	\$40,630	1%	4%	\$40,181

(1) Excludes the effect of foreign currency translation on reported sales.

na Not applicable.

Restaurant expansion, partly offset by negative comparable sales, drove the consolidated constant currency sales increases in 2002 and 2001. (Comparable sales represent the percent change in constant currency sales from the same period in the prior year for restaurants in operation at least thirteen months.)

Sales in the U.S. increased in 2002 and 2001 due to expansion. Results in 2002 reflected the overall slowdown in the restaurant industry and increased competition.

The primary contributors to Europe's constant currency sales growth in both years were France and Russia. In addition, the U.K. contributed to the increases in 2002 and 2001, although comparable sales were negative in both years. Europe's results for both years were impacted by negative comparable sales in Germany, where the economy continued to contract. We expect the difficult economic conditions in Germany to continue in the near term. In 2001, despite the Company's outstanding quality and safety record, Europe's results were negatively impacted by consumer confidence issues regarding the European beef supply in several markets.

Sales results in APMEA declined in 2002 in constant currencies primarily due to negative comparable sales in Japan, which were in part due to continuing weak economic conditions, partly offset by a strong performance in Australia and expansion in China. In 2001, the constant currency sales increase was driven by strong results in China, partly offset by weak results in Japan, Taiwan and Turkey, and weak consumer spending in Australia. Beginning in late 2001 and continuing in 2002, sales were also dampened by consumer confidence issues regarding food safety throughout Japan.

In Latin America, constant currency sales increased in both 2002 and 2001, despite the fact that many markets continued to be impacted by weak economic conditions. The increase in 2002 was primarily due to positive comparable sales in Brazil and expansion in Mexico, while in 2001 positive comparable sales in Mexico and Venezuela drove the increase.

The Company expects the weak economic conditions in many markets in APMEA (including Japan) and Latin America to continue in the near term.

In Canada, constant currency sales increased in 2002 due to expansion, partly offset by negative comparable sales, while the 2001 constant currency sales increase was driven by positive comparable sales and expansion.

The sales increase in Partner Brands in 2002 was primarily due to expansion and positive comparable sales at Chipotle. The sales increase in 2001 was primarily due to the acquisition of Boston Market in second quarter 2000. In addition, expansion of Chipotle along with strong comparable sales at Chipotle and Boston Market helped drive the increase in 2001.

#### Comparable sales—McDonald's restaurants

		Increase/(decrease)	
	2002	2001	2000
U.S.	<b>(1.5)%</b>	0.1 %	1.0 %
Europe	<b>1.0</b>	(1.4)	0.4
APMEA	<b>(8.5)</b>	(4.8)	(0.1)
Latin America	<b>1.0</b>	(3.9)	(3.6)
Canada	<b>(2.5)</b>	1.3	4.7
Brand McDonald's	<b>(2.1)%</b>	(1.3)%	0.6 %

#### Average annual sales—McDonald's restaurants

Average sales per restaurant in constant currencies are affected by comparable sales as well as the size, location and number of new restaurants. The number of new restaurants affects average sales because new restaurants typically take a few years to reach long-term sales volumes. In addition, over the last several years more restaurants outside the U.S. have opened in less populated areas and in countries with lower average sales volumes and correspondingly lower average development costs.

#### Average annual sales—McDonald's restaurants

DOLLARS IN THOUSANDS	As reported amounts			Constant currency increase/(decrease) <sup>(2)</sup>	
	2002	2001	2000	2002	2001
<b>Per restaurant<sup>(1)</sup></b>					
<i>Traditional:</i>					
U.S.	<b>\$1,628</b>	\$1,650	\$1,647	<b>(1)%</b>	—
Europe	<b>1,821</b>	1,722	1,851	—	(4)%
APMEA	<b>1,091</b>	1,190	1,376	<b>(8)</b>	(5)
Latin America	<b>931</b>	1,154	1,333	<b>1</b>	(5)
Canada	<b>1,395</b>	1,469	1,530	<b>(4)</b>	—
<i>Satellite:</i>					
U.S.	<b>\$ 554</b>	\$ 546	\$ 536	<b>1 %</b>	2 %
Outside the U.S. <sup>(3)</sup>	<b>483</b>	533	598	<b>(7)</b>	(1)

(1) McDonald's restaurants in operation at least 13 consecutive months.

(2) Excludes the effect of foreign currency translation on reported results.

(3) Satellite restaurants are primarily located in Japan and Canada.

In 2002, average annual sales per traditional restaurant in the U.S. declined slightly primarily due to negative comparable sales. In Europe, average annual sales per traditional restaurant were relatively flat in constant currencies. In APMEA and Canada, average annual sales per traditional restaurant declined in constant currencies primarily due to negative

comparable sales and the impact of new restaurants. In Latin America, average annual sales per traditional restaurant increased slightly in constant currencies due to positive comparable sales. All segments benefited from the closing of underperforming restaurants in 2002 and 2001.

In 2001, average annual sales per traditional restaurant were relatively flat for the U.S. and Canada in constant currencies. In other segments, negative comparable sales and the significant number of new restaurants, partly offset by the benefit of closing underperforming restaurants, drove the decreases in average annual sales per traditional restaurant.

Satellite restaurants generally have significantly lower development costs and sales volumes than traditional restaurants. The use of these small, limited-menu restaurants has allowed profitable expansion into areas that otherwise would not be feasible (e.g., discount retail stores and airports). In 2002 and 2001, average annual sales for satellite restaurants increased in the U.S. This was due in part to our continued assessment of the appropriate use of these limited-menu sites and the closing of certain low-volume sites. Outside the U.S., average annual sales for satellite restaurants declined in constant currencies in both years primarily due to negative comparable sales in Japan, where the majority of satellites outside the U.S. are located. In connection with the restaurant closings previously discussed, the Company's Japanese affiliate will close more than 100 satellite restaurants in 2003.

#### REVENUES

Revenues include sales by Company-operated restaurants and fees from restaurants operated by franchisees or affiliates under joint-venture agreements. These fees include rent, service fees and/or royalties that are based on a percent of sales with specified minimum payments along with initial fees. Fees vary by type of site and investment by the Company and also according to local business conditions. These fees, along with occupancy and operating rights, are stipulated in franchise agreements that generally have 20-year terms.

Revenues grow as sales build in existing restaurants and as new restaurants are added. Menu price changes also affect revenues and sales, but it is impractical to quantify their impact because of different pricing structures, new products, promotions and product-mix variations among restaurants and markets.

Systemwide sales and revenues may grow at different rates during a given period, primarily due to a change in the mix of Company-operated, franchised and affiliated restaurants. For example, this mix is impacted by purchases and sales of restaurants between the Company and franchisees. Company-operated restaurants generated about 30% of Systemwide sales and about 75% of revenues for all periods presented.



Revenues									
DOLLARS IN MILLIONS	2002			2001			2000		
	As reported amount	Increase/(decrease) As Constant reported currency <sup>(1)</sup>	As reported amount	As reported amount	Increase/(decrease) As Constant reported currency <sup>(1)</sup>	As reported amount	As reported amount	Increase/(decrease) As Constant reported currency <sup>(1)</sup>	As reported amount
Company-operated sales:									
U.S.	\$ 3,172	1%	na	\$ 3,139	2%	na	\$ 3,064		
Europe	3,982	7	2%	3,727	-	4%	3,730		
APMEA	2,115	9	8	1,938	4	11	1,857		
Latin America	696	(15)	12	821	7	18	764		
Canada	505	6	7	478	(2)	2	490		
Partner Brands	1,030	10	10	938	67	67	562		
Total Company-operated sales	\$11,500	4%	4%	\$11,041	5%	9%	\$10,467		
Franchised and affiliated revenues:									
U.S.	\$ 2,251	-	na	\$ 2,257	3%	na	\$ 2,195		
Europe	1,154	13%	6%	1,025	-	4%	1,024		
APMEA	253	(5)	(6)	265	8	21	245		
Latin America	118	(21)	(8)	150	(19)	(11)	185		
Canada	128	(2)	-	130	4	8	125		
Partner Brands	2	-	-	2	-	-	2		
Total franchised and affiliated revenues	\$ 3,906	2%	1%	\$ 3,829	1%	4%	\$ 3,776		
Total revenues:									
U.S.	\$ 5,423	1%	na	\$ 5,396	3%	na	\$ 5,259		
Europe	5,136	8	3%	4,752	-	4%	4,754		
APMEA	2,368	7	7	2,203	5	12	2,102		
Latin America	814	(16)	9	971	2	12	949		
Canada	633	4	6	608	(1)	3	615		
Partner Brands	1,032	10	10	940	67	67	564		
Total revenues	\$15,406	4%	4%	\$14,870	4%	8%	\$14,243		

(1) Excludes the effect of foreign currency translation on reported revenues.

na Not applicable.

On a constant currency basis, total revenues increased at a higher rate than Systemwide sales in 2002 primarily due to significantly lower sales from our affiliate in Japan. Under our affiliate structure, we record a royalty in revenues based on a percentage of Japan's sales, whereas all of Japan's sales are included in Systemwide sales. For this reason, Japan's sales decline had a larger negative impact on Systemwide sales than on revenues. In 2001, total revenues increased at a higher rate than Systemwide sales primarily due to the second quarter 2000 acquisition of Boston Market restaurants, which were all Company-operated, and the restructuring of our ownership in the Philippines, effective July 1, 2001. As a result of the restructuring, most of our restaurants in the Philippines are now Company-operated rather than franchised. In addition, revenues in 2001 benefited from an increase in the royalty percent received from our Japanese affiliate, effective January 1, 2001.

In the U.S., growth rates for Systemwide sales and total revenues were similar in 2002 and 2001. In both periods, Europe's total revenue growth rates were lower than the Systemwide sales growth rates primarily due to a lower percentage of Company-operated restaurants and an increase in rent assistance to franchisees compared with the prior year. APMEA's total revenue growth rates were higher than the

Systemwide sales growth rates for both periods primarily due to our affiliate structure in Japan and a higher percentage of Company-operated restaurants, in part due to the restructuring of the Philippines. In addition, the total revenue growth rate in 2001 benefited from an increase in the royalty percent received from our Japanese affiliate. In Latin America, total revenue growth rates were higher than Systemwide sales growth rates for both periods primarily due to a higher percentage of Company-operated restaurants compared with the prior year.

#### OPERATING INCOME

Consolidated operating income decreased \$584 million or 22% in 2002 and \$633 million or 19% in 2001; however, significant charges of \$853 million in 2002 and \$378 million in 2001 were included in operating income. Operating income for both years included higher selling, general & administrative expenses and lower other operating income. Combined operating margin dollars were higher in 2002 than in 2001 and lower in 2001 than in 2000.

Operating income from the major markets accounted for substantially all of consolidated operating income in 2002, 2001 and 2000.

The following table presents reported operating income amounts and growth rates along with the growth rates adjusted for foreign currency translation and significant items. Adjusted constant currency operating income is one of the primary measures used to evaluate segment performance, because management believes that adjusted constant currency operating income reflects the most accurate representation of ongoing business operations.

Operating income									
DOLLARS IN MILLIONS	2002			2001			2000		
	As reported	Increase/(decrease)	As reported amount	As reported	Increase/(decrease)	As reported amount	As reported	Increase/(decrease)	As reported amount
	amount	As reported constant currency <sup>(1)</sup>		amount	As reported constant currency <sup>(1)</sup>		amount	As reported constant currency <sup>(1)</sup>	
U.S.	\$1,673	3%	(2)%	\$1,622	(10)%	-	\$1,795		
Europe	1,022	(4)	-	1,063	(10)	(3)%	1,180		
APMEA	64	(80)	(23)	325	(28)	(10)	451		
Latin America	(133)	nm	nm	11	(89)	(46)	103		
Canada	125	1	2	124	(2)	10	126		
Partner Brands	(66)	-	22	(66)	(61)	-	(41)		
Corporate	(572)	(50)	(8)	(382)	(35)	(22)	(284)		
Total	\$2,113	(22)%	(6)%	\$2,697	(19)%	(5)%	\$3,330		

(1) Excludes the effect of foreign currency translation on reported results and the significant items discussed on page 2 and shown in the following tables.

nm Not meaningful.

The following table presents reconciliations of reported operating results to adjusted constant currency operating results by segment for both 2002 and 2001.

Reconciliation of reported operating results to adjusted constant currency operating results								
DOLLARS IN MILLIONS	U.S.	Europe	APMEA	Latin America	Canada	Partner Brands	Corporate	Consolidated
<b>2002</b>								
<b>As reported operating income (loss)</b>	<b>\$1,673</b>	<b>\$1,022</b>	<b>\$ 64</b>	<b>\$(133)</b>	<b>\$125</b>	<b>\$(66)</b>	<b>\$(572)</b>	<b>\$2,113</b>
Restructuring charges	25	9	141	66	2	3	21	267
Restaurant closings/asset impairment	74	135	81	62	4	31	15	402
Technology write-offs and other charges		4		14	4		162	184
Currency effect		(61)	(6)	(22)	2			(87)
<b>Adjusted constant currency operating income (loss)</b>	<b>\$1,772</b>	<b>\$1,109</b>	<b>\$280</b>	<b>\$ (13)</b>	<b>\$137</b>	<b>\$(32)</b>	<b>\$(374)</b>	<b>\$2,879</b>
<b>2001</b>								
<b>As reported operating income (loss)</b>	<b>\$ 1,622</b>	<b>\$ 1,063</b>	<b>\$ 325</b>	<b>\$ 11</b>	<b>\$ 124</b>	<b>\$(66)</b>	<b>\$(382)</b>	<b>\$ 2,697</b>
Restructuring charges	156	7	3	3	6	5	20	200
Restaurant closings/asset impairment		39	35	37	4	20		135
Technology write-offs and other charges	25		4				14	43
Currency effect		37	38	4	5			84
<b>Adjusted constant currency operating income (loss)</b>	<b>\$ 1,803</b>	<b>\$ 1,146</b>	<b>\$ 405</b>	<b>\$ 55</b>	<b>\$ 139</b>	<b>\$(41)</b>	<b>\$(348)</b>	<b>\$ 3,159</b>

U.S. adjusted operating income decreased 2% in 2002 and was relatively flat in 2001 compared with 2000. The decrease in 2002 was due to lower combined operating margin dollars and lower other operating income, partly offset by lower selling, general & administrative expenses. Other operating income included \$22 million of payments made to U.S. owner/operators to facilitate the introduction of a new front counter team service system. In 2001, higher combined operating margin dollars were offset by higher selling, general & administrative expenses and slightly lower other operating income. U.S. adjusted operating income accounted for more than 50% of consolidated adjusted operating income in 2002, 2001 and 2000.

Europe's adjusted operating income accounted for more than 35% of consolidated adjusted operating income in 2002, 2001 and 2000. Europe's adjusted operating income was relatively flat in 2002 compared with 2001 and decreased 3% in 2001. The segment's results benefited from strong performances in France and Russia in both years; however, difficult economic conditions in Germany and weak results in the U.K. negatively impacted results. In 2001, consumer confidence issues regarding the European beef supply negatively impacted Europe's results. France, Germany and the U.K. accounted for about 75% of Europe's adjusted operating income in all three years.

APMEA's adjusted operating income decreased 23% in 2002 and 10% in 2001. In 2002, strong results in Australia were more than offset by weak results in Japan and Hong Kong. In 2001, strong results in China, the increase in the

royalty percent received from our affiliate in Japan and a gain on the sale of real estate in Singapore were more than offset by weak results in Australia, Japan, Taiwan and Turkey. Australia, Japan and China accounted for about 70% of APMEA's adjusted operating income in all three years.

Latin America's adjusted operating income declined significantly for both periods due to the continuing difficult economic conditions experienced by most markets in the segment. In addition, Latin America's results in 2002 were negatively impacted by a higher provision for uncollectible receivables as well as the temporary closure of all McDonald's restaurants in Venezuela due to the national strike that began in early December 2002. Although the strike ended in February 2003, the Company expects the continued turmoil in Venezuela to impact results in 2003.

The adjusted operating results for the Partner Brands improved 22% in 2002 and were flat in 2001 compared with 2000. The improvement in 2002 was primarily driven by the elimination of goodwill amortization beginning January 1, 2002 and continued strong results at Chipotle.

The Corporate segment reflected higher spending on technology in 2002 and 2001.

#### OPERATING MARGINS

Operating margin information and discussions relate to McDonald's restaurants only and exclude Partner Brands.

#### Company-operated margins

Company-operated margin dollars represent sales by Company-operated restaurants less the operating costs of these restaurants. Company-operated margin dollars declined \$12 million in 2002 and \$145 million in 2001. In constant currencies, Company-operated margin dollars declined \$41 million or 3% in 2002 and \$96 million or 6% in 2001.

The constant currency decreases in both years were primarily due to negative comparable sales and higher labor rates, partly offset by expansion.

#### Company-operated margins — McDonald's restaurants

IN MILLIONS	2002	2001	2000
U.S.	\$ 507	\$ 501	\$ 521
Europe	631	626	683
APMEA	239	240	296
Latin America	66	83	95
Canada	70	75	75
Total	\$1,513	\$1,525	\$1,670

#### PERCENT OF SALES

U.S.	16.0%	16.0%	17.0%
Europe	15.9	16.8	18.3
APMEA	11.3	12.4	15.9
Latin America	9.4	10.1	12.4
Canada	13.7	15.6	15.4
Total	14.4%	15.1%	16.9%

Operating cost trends as a percent of sales were as follows: food & paper costs decreased in 2002 and increased in 2001; payroll costs as well as occupancy & other operating expenses increased for both periods.

The U.S. Company-operated margin percent in 2002 benefited from the elimination of goodwill amortization and a lower contribution rate to the national co-op for advertising expenses. However, these benefits were offset by negative comparable sales and higher labor costs. Food & paper costs were lower as a percent of sales in 2002 and 2001, while payroll costs were higher in both years. Occupancy & other operating expenses as a percent of sales were lower in 2002 than in 2001 and higher in 2001 than in 2000.

Europe's Company-operated margins as a percent of sales declined in 2002, primarily due to higher payroll and occupancy costs, partly offset by lower food & paper costs as a percent of sales. In 2001, Europe's Company-operated margin percent declined, primarily due to higher payroll costs and negative comparable sales.

In APMEA, negative comparable sales in 2002 and 2001 affected Company-operated margins as a percent of sales. In 2001, a change in restaurant classification in the Philippines also contributed to APMEA's margin decline because its Company-operated margins were lower than the average for the segment. In Latin America, declines in margins as a percent of sales in both years were due to difficult economic conditions in most markets. In Canada, negative comparable sales in 2002 affected Company-operated margins as a percent of sales.

#### Franchised margins

Franchised margin dollars represent revenues from franchised and affiliated restaurants less the Company's occupancy costs (rent and depreciation) associated with those sites. Franchised margin dollars represented more than 60% of the combined operating margins in 2002, 2001 and 2000. Franchised margin dollars increased \$36 million in 2002 and \$26 million in 2001. In constant currencies, franchised margin dollars were relatively flat in 2002 and increased \$91 million or 3% in 2001. The constant currency increase in 2001 was primarily driven by expansion and an increase in the Japan royalty percent.

#### Franchised margins — McDonald's restaurants

IN MILLIONS	2002	2001	2000
U.S.	\$1,781	\$1,799	\$1,765
Europe	885	792	802
APMEA	217	229	199
Latin America	79	103	135
Canada	102	105	101
Total	\$3,064	\$3,028	\$3,002

#### PERCENT OF REVENUES

U.S.	79.1%	79.7%	80.4%
Europe	76.7	77.2	78.3
APMEA	85.8	86.2	81.5
Latin America	66.9	68.4	73.0
Canada	79.2	80.4	80.2
Total	78.5%	79.1%	79.5%

The declines in the consolidated franchised margin percent in 2002 and 2001 reflected negative comparable sales, higher rent assistance to franchisees primarily in the U.S. and Europe, and higher occupancy costs, due in part to an increased proportion of leased sites in all geographic segments. APMEA's franchised margin percent in both years benefited from the restructuring of our ownership in the Philippines in July 2001. The restructuring resulted in the reclassification of restaurants and related margins, which were lower than the average for the segment, from franchised to Company-operated. In addition, the franchised margin percent in APMEA in 2001 benefited from the increase in the Japan royalty percent.



## SELLING, GENERAL &amp; ADMINISTRATIVE EXPENSES

Consolidated selling, general & administrative expenses increased 3% in 2002 and 5% in 2001 (4% and 7% in constant currencies). The increase in 2002 was primarily due to increased spending on technology in the Corporate segment, higher advertising expenses in the U.S. primarily related to the introduction of the Dollar Menu, and higher expenses for Partner Brands. The increase in 2001 was due to increased spending on technology in the Corporate segment and higher expenses for Partner Brands, partly offset by lower Company-wide performance-based incentive compensation compared with the prior year. Selling, general & administrative expenses as a percent of sales were 4.1% in 2002 and 2001 and 4.0% in 2000.

## Selling, general &amp; administrative expenses

DOLLARS IN MILLIONS	2002			2001			2000
	As reported amount	Increase/(decrease) As reported Constant currency <sup>(1)</sup>	As reported amount	Increase/(decrease) As reported Constant currency <sup>(1)</sup>	As reported amount	As reported amount	
U.S.	\$ 558	(1)%	na	\$ 563	1%	na	\$ 559
Europe	359	9	4%	328	(2)	1%	336
APMEA	158	4	3	152	2	9	149
Latin America	102	(19)	3	126	5	14	120
Canada	49	(3)	(2)	51	(6)	(2)	54
Partner Brands	114	13	12	102	20	20	85
Corporate <sup>(2)</sup>	373	10	na	340	20	na	284
Total	\$1,713	3%	4%	\$1,662	5%	7%	\$1,587

(1) Excludes the effect of foreign currency translation on reported expenses.

(2) Corporate expenses consist of home office support costs in areas such as facilities, finance, human resources, information technology, legal, supply chain management and training.

na Not applicable.

## OTHER OPERATING (INCOME) EXPENSE, NET

Other operating (income) expense includes gains on sales of restaurant businesses, equity in earnings of unconsolidated affiliates, restructuring charges, restaurant closings/asset impairment charges and other transactions related to franchising and the food service business.

## Other operating (income) expense, net

IN MILLIONS	2002	2001	2000
Gains on sales of restaurant businesses	\$ (114)	\$ (112)	\$ (87)
Equity in earnings of unconsolidated affiliates	(24)	(63)	(121)
Team service system payments—U.S.	22		
Bad debts and other expense	96	54	12
Significant items: <sup>(1)</sup>			
Restructuring charges	267	200	
Restaurant closings/asset impairment	402	135	
Technology write-offs and other charges	184	43	
Total significant items	853	378	
Total	\$ 833	\$ 257	\$ (196)

(1) See other operating (income) expense, net note to consolidated financial statements on page 24 for discussion of significant items and a summary of the activity in the related liabilities.

## Gains on sales of restaurant businesses

Gains on sales of restaurant businesses include gains from sales of Company-operated restaurants as well as gains from exercises of purchase options by franchisees with business facilities lease arrangements (arrangements where the Company leases the businesses, including equipment, to franchisees who have options to purchase the businesses). The Company's purchases and sales of businesses with its franchisees and affiliates are aimed at achieving an optimal ownership mix in each market. Resulting gains or losses are recorded in operating income because the transactions are an integral part of our business.

## Equity in earnings of unconsolidated affiliates

Equity in earnings of unconsolidated affiliates—businesses in which the Company actively participates but does not control—is reported after interest expense and income taxes, except for U.S. restaurant partnerships, which are reported before income taxes. The decrease in 2002 was due to a net loss from our Japanese affiliate. The decrease in 2001 was due to lower earnings from our Japanese affiliate, the increase in Japan's royalty expense and a weaker Japanese Yen. Although the increase in royalty expense reduced McDonald's equity in earnings for Japan in 2001 compared with 2000, it was more than offset at the operating income level by the royalty benefit McDonald's received in franchised revenues.

## Team service system payments

In 2002, the Company made payments to U.S. owner/operators to facilitate the introduction of a new front counter team service system.

## Bad debts and other expense

Bad debts and other expense for 2002 and 2001 increased primarily due to higher provisions for uncollectible receivables (primarily in Europe and Latin America). In addition, other expense for 2002 was partly offset by a benefit from the elimination of goodwill amortization.

## INTEREST EXPENSE

Interest expense decreased in 2002 due to lower average interest rates, partly offset by higher average debt levels and stronger foreign currencies. Interest expense increased in 2001 due to higher average debt levels, partly offset by weaker foreign currencies and lower average interest rates. Average debt levels were higher in both years because the Company used its available credit capacity to repurchase shares of its common stock.

## NONOPERATING EXPENSE, NET

Nonoperating expense includes miscellaneous income and expense items such as interest income, minority interests, and gains and losses related to other investments, financings and translation. Nonoperating expense in 2002 reflected higher minority interest expense and foreign currency translation losses in 2002 compared with foreign currency translation gains in 2001. In addition, nonoperating expense in 2001 included \$12 million primarily related to the write-off of a corporate investment as well as minority interest expense related to the sale of real estate in Singapore.

## PROVISION FOR INCOME TAXES

The following table presents the reported effective income tax rates as well as the effective income tax rates excluding significant items.

	2002	2001	2000
Reported effective income tax rates	<b>40.3 %</b>	29.8%	31.4%
Impact of significant items <sup>(1)</sup>	<b>(7.6)</b>	1.3	—
Effective income tax rates, excluding significant items	<b>32.7 %</b>	31.1%	31.4%

(1) Certain significant items were not tax-affected for financial reporting purposes. See page 2 for discussion of significant items.

The 2001 effective income tax rate reflected a benefit from the impact of tax law changes in certain international markets and the 2000 effective income tax rate reflected a tax benefit resulting from an international transaction.

Consolidated net deferred tax liabilities included tax assets, net of valuation allowance, of \$867 million in 2002 and \$720 million in 2001. Substantially all of the net tax assets arose in the U.S. and other profitable markets.

## CUMULATIVE EFFECT OF ACCOUNTING CHANGE

Effective January 1, 2002, the Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, which eliminates the amortization of goodwill and instead subjects it to annual impairment tests. As a result of the initial required goodwill impairment test, the Company recorded a noncash charge of \$99 million after tax (\$0.07 per diluted share) in first quarter 2002 to reflect the cumulative effect of this accounting change. The impaired goodwill was primarily in Argentina, Uruguay and other markets in Latin America and the Middle East, where economies have weakened significantly in recent years.

## NET INCOME AND NET INCOME PER COMMON SHARE

In 2002, income before the cumulative effect of the goodwill accounting change decreased \$645 million or 39%, and diluted income per common share before the cumulative effect of this accounting change decreased \$0.48 or 38%. Net income, which included the charge for the cumulative effect of the accounting change decreased 45% and diluted net income per common share decreased 44%. In 2001, net income decreased \$340 million or 17% and diluted net income per common share decreased \$0.21 or 14%. Results for 2002 included significant charges of \$700 million or \$0.55 per share, and results for 2001 included significant items totaling \$143 million or \$0.11 of expense per share discussed on page 2.

## CASH FLOWS

The Company generates significant cash from operations and has substantial credit capacity to fund operating and discretionary spending. Cash from operations totaled \$2.9 billion and exceeded capital expenditures by \$886 million in 2002, while cash from operations totaled \$2.7 billion and exceeded capital expenditures by \$782 million in 2001. Cash provided by operations, along with borrowings and other sources of cash, is used for capital expenditures, share repurchases, dividends and debt repayments. The Company expects to use future cash provided by operations to fund the remaining employee severance and lease obligations associated with the significant charges in 2002 and 2001.

## Cash provided by operations

DOLLARS IN MILLIONS	2002	2001	2000
Cash provided by operations	<b>\$2,890</b>	\$2,688	\$2,751
Cash provided by operations as a percent of capital expenditures	<b>144%</b>	141%	141%
Cash provided by operations as a percent of average total debt	<b>31%</b>	31%	35%

In addition to its cash provided by operations, the Company can meet short-term funding needs through commercial paper borrowings and line of credit agreements. Accordingly, the Company purposefully maintains a relatively low current ratio, which was .71 at year-end 2002.

## RESTAURANT DEVELOPMENT AND CAPITAL EXPENDITURES

Systemwide restaurants at year end<sup>(1)</sup>

	2002	2001	2000
U.S.	<b>13,491</b>	13,099	12,804
Europe	<b>6,070</b>	5,794	5,460
APMEA	<b>7,555</b>	7,321	6,771
Latin America	<b>1,605</b>	1,581	1,510
Canada	<b>1,304</b>	1,223	1,154
Partner Brands:			
Boston Market	<b>662</b>	657	707
Chipotle	<b>232</b>	177	104
Donatos	<b>181</b>	197	156
Other	<b>8</b>	44	41
Total Partner Brands	<b>1,083</b>	1,075	1,008
Total	<b>31,108</b>	30,093	28,707

(1) Includes satellite units at December 31, 2002, 2001 and 2000 as follows:  
U.S.—1,159, 1,004, 999; Europe—102, 63, 46; APMEA (primarily Japan)—1,923, 1,879, 1,681; Latin America—19, 46, 45; and Canada—330, 307, 280.

In 2002, the Company opened 1,247 traditional McDonald's restaurants and 392 satellite restaurants, and closed 474 traditional restaurants and 158 satellite restaurants. In 2001, the Company opened 1,406 traditional McDonald's restaurants and 383 satellite restaurants, and closed 335 traditional restaurants and 135 satellite restaurants.

In 2002, about 85% of McDonald's restaurant additions occurred in the major markets. Approximately 60% of Company-operated restaurants and more than 85% of franchised restaurants were located in the major markets at the end of 2002. Franchisees and affiliates operated 73% of

McDonald's restaurants at year-end 2002. Partner Brand restaurants are primarily Company-operated.

Capital expenditures increased \$98 million or 5% in 2002 and decreased \$39 million or 2% in 2001. The increase in capital expenditures in 2002 was primarily due to higher spending for McDonald's restaurant business in the U.S. and Canada, partly offset by lower capital expenditures for new restaurants in Latin America. The decrease in 2001 was primarily due to lower spending in Europe and Latin America and weaker foreign currencies, partly offset by additional expenditures for Partner Brands as well as for McDonald's restaurant business in the U.S. and China. Capital expenditures for McDonald's restaurants in 2002, 2001 and 2000 reflected our strategy of leasing a higher proportion of new sites and also the U.S. building program, which gave franchisees the option to own new restaurant buildings.

The Company's expenditures for new restaurants in the U.S. were lower than they would have been as a result of the leasing strategy and the U.S. building program. About 65% in 2002 and 80% in 2001 of new and rebuilt U.S. traditional franchised and affiliated restaurant buildings were purchased by franchisees and affiliates. Beginning in 2003, to give our best franchisees additional financial flexibility to purchase more McDonald's restaurant businesses as well as to reinvest in their existing restaurants, the Company plans to purchase buildings for new franchised restaurants. As a result of owning the buildings, the Company expects to collect additional rent from the franchisees. In addition, the Company is purchasing a higher proportion of land for new restaurants in the U.S.

The Company and its affiliates owned 38% of the land for its restaurant sites at year-end 2002 and 2001. For leased land, the Company maintains long-term occupancy rights for the land and receives related rental income.

Capital expenditures invested in major markets excluding Japan represented approximately 70% of the total in 2002 and 60% in 2001 and 2000. (Japan is accounted for under the equity method, and accordingly, its capital expenditures are not included in consolidated amounts.)

Capital expenditures			
IN MILLIONS	2002	2001	2000
New restaurants	\$ 1,161	\$ 1,198	\$ 1,308
Existing restaurants <sup>(1)</sup>	659	571	507
Other properties <sup>(2)</sup>	184	137	130
Total	\$ 2,004	\$ 1,906	\$ 1,945
Total assets	\$23,971	\$22,535	\$21,684

(1) Includes technology to improve service and food quality and enhancements to facilities to achieve higher levels of customer satisfaction.

(2) Primarily for computer equipment and furnishings for office buildings.

Average development costs incurred by the U.S. System (land, building and equipment) for new traditional McDonald's restaurants were \$1.7 million in 2002 and 2001 and \$1.6 million in 2000.

Average development costs outside the U.S. vary widely by market depending on the types of restaurants built and the real estate and construction costs within each market. These

costs, which include land, buildings and equipment owned by the Company, are managed through the use of optimally sized restaurants, construction and design efficiencies, standardization and global sourcing. In addition, foreign currency fluctuations affect average development costs.

Average development costs for new traditional McDonald's restaurants in major markets outside the U.S. excluding Japan were approximately \$1.6 million in 2002, 2001 and 2000. Average annual sales for new traditional McDonald's restaurants in the same markets were about \$1.3 million in 2002 and 2001 and \$1.5 million in 2000. Average development costs for new satellite restaurants (excluding lease costs) located in Canada, Germany and Japan, which comprise about 95% of the satellites outside the U.S., were about \$250,000 in 2002 and about \$220,000 in 2001 and 2000. The use of these small, limited-menu restaurants, for which the land and building generally are leased, has allowed expansion into areas that otherwise would not have been feasible.

Capital expenditures by affiliates in international markets, primarily Japan, which were not included in consolidated amounts, were about \$204 million in 2002, \$181 million in 2001 and \$204 million in 2000.

#### OFF-BALANCE SHEET ARRANGEMENTS

The Company and six unaffiliated companies that supply the "McDonald's System" (McDonald's franchisees, suppliers and the Company) are equal owners of System Capital Corporation (SCC). SCC's purpose is to provide funding to McDonald's franchisees, suppliers to the McDonald's System and McDonald's Corporation and to build equity within SCC that will benefit the McDonald's System. No employees of SCC are employees of the seven shareholders. SCC competes with other lenders who provide similar financing to McDonald's franchisees and suppliers and the Company has no independent obligation to provide financing to these franchisees and suppliers. SCC's function is similar to that of a cooperative and its primary operating activities include (1) providing loans to qualifying U.S. franchisees to purchase existing restaurant businesses as well as finance equipment, buildings and working capital, (2) purchasing accounts receivable and financing inventory and other needs of eligible suppliers and distributors, and (3) acquiring land and leasing it to McDonald's Corporation for new restaurants, primarily in the U.S.

SCC assets totaled \$1.7 billion at December 31, 2002.

See summary of significant accounting policies on page 23 for further details on SCC.

#### SHARE REPURCHASES AND DIVIDENDS

During 2002, the Company purchased 25.6 million shares of McDonald's stock for approximately \$687 million, of which 20.1 million shares for \$536 million were under a new \$5.0 billion share repurchase program.

During 2001 and 2000, the Company sold 12.2 million and 16.8 million common equity put options, respectively, in connection with its share repurchase program. Premiums received were recorded in shareholders' equity as a reduction of the cost of treasury stock purchased and were \$32 million



in 2001 and \$56 million in 2000. In 2002, 10.1 million common equity put options were exercised and 2.1 million options expired unexercised, while 21.0 million options were exercised in 2001. The total amount paid to acquire these shares as a result of the options being exercised was \$286 million in 2002 and \$700 million in 2001. At December 31, 2002, there were no common equity put options outstanding. At December 31, 2001, the \$350 million total exercise price of outstanding options was classified in common equity put options and forward contracts in the Consolidated balance sheet, and the related offset was recorded in common stock in treasury, net of premiums received.

During 2001, the Company also entered into equity forward contracts in connection with its share repurchase program. At December 31, 2001, the \$151 million total purchase price of the forward contracts was classified in common equity put options and forward contracts in the Consolidated balance sheet, and the related offset was recorded in common stock in treasury. The forward contracts for 5.5 million shares settled in March 2002, and there were no additional forward contracts outstanding at December 31, 2002.

The Company has paid dividends on common stock for 27 consecutive years and has increased the dividend amount every year. Additional dividend increases will be considered after reviewing returns to shareholders, profitability expectations, financing needs and tax treatment of dividends. Cash dividends are declared and paid on an annual basis. As in the past, future dividends will be declared at the discretion of the Board of Directors.

## FINANCIAL POSITION AND CAPITAL RESOURCES

### TOTAL ASSETS AND RETURNS

Total assets grew by \$1.4 billion or 6% in 2002 and \$851 million or 4% in 2001. Changes in foreign currency exchange rates increased total assets by approximately \$785 million in 2002 and decreased total assets by approximately \$765 million in 2001. At year-end 2002 and 2001, approximately 65% of consolidated assets was located in the major markets excluding Japan. Net property and equipment rose \$1.3 billion in 2002 and represented 78% of total assets at year end.

Operating income is used to compute return on average assets, while income before cumulative effect of accounting change is used to calculate return on average common equity. Month-end balances are used to compute both average assets and average common equity.

#### Returns on assets and equity

	2002	2001	2000
Return on average assets	<b>9.2%</b>	12.3%	15.9%
Return on average common equity	<b>8.9</b>	17.5	21.6
Adjusted return on average assets <sup>(1)</sup>	<b>12.9%</b>	14.1%	na
Adjusted return on average common equity <sup>(1)</sup>	<b>16.8</b>	19.1	na

(1) Excludes the significant items noted on page 2.

na Not applicable.

Return on average assets and return on average common equity both declined in 2002 and 2001, primarily due to weak operating results in APMEA and Latin America. During 2003, the Company will continue to concentrate McDonald's restaurant openings in markets with acceptable returns and will significantly reduce the amount of capital we invest in APMEA and Latin America, where returns have been pressured in recent years by weak economies.

### FINANCINGS AND MARKET RISK

The Company generally borrows on a long-term basis and is exposed to the impact of interest-rate changes and foreign currency fluctuations. Debt obligations at December 31, 2002 totaled \$10.0 billion compared with \$8.9 billion at December 31, 2001. The increase in 2002 was due to the impact of changes in exchange rates on foreign currency-denominated debt (\$645 million), SFAS No. 133 noncash fair value adjustments (\$271 million), and an increase in net borrowings (\$145 million).

#### Debt highlights<sup>(1)</sup>

	2002	2001	2000
Fixed-rate debt as a percent of total debt <sup>(2)</sup>	<b>62%</b>	45%	58%
Weighted-average annual interest rate of total debt	<b>4.1</b>	5.4	5.8
Foreign currency-denominated debt as a percent of total debt <sup>(2)</sup>	<b>64</b>	57	60
Total debt as a percent of total capitalization (total debt and total shareholders' equity)	<b>49</b>	48	48

(1) All percentages are as of December 31, except for the weighted-average annual interest rate, which is for the year.

(2) Includes the effect of interest-rate and foreign currency exchange agreements, and excludes the effect of SFAS No. 133 fair value adjustments.

Moody's, Standard & Poor's and Fitch currently rate McDonald's commercial paper P-1, A-1 and F1 and its long-term debt A2, A+ and A, respectively. The Company has not historically experienced difficulty in obtaining financing or refinancing existing debt. Certain of the Company's debt obligations contain cross-acceleration provisions and restrictions on Company and subsidiary mortgages and the long-term debt of certain subsidiaries. In addition, the Company is required to maintain a minimum net worth (defined as consolidated assets less consolidated liabilities) of \$5 billion to comply with its line of credit agreements. There are no provisions in the Company's debt obligations that would accelerate repayment of debt as a result of a change in credit ratings. The Company has \$1.3 billion available under committed line of credit agreements (see debt financing note on page 27) as well as \$1.8 billion under a U.S. shelf registration and \$700 million under a Euro Medium-Term Notes program for future debt issuance.

The Company uses major capital markets, bank financings and derivatives to meet its financing requirements and reduce interest expense. The Company manages its debt portfolio in response to changes in interest rates and foreign currency rates by periodically retiring, redeeming and repurchasing debt, terminating exchange agreements and using derivatives.

The Company does not use derivatives with a level of complexity or with a risk higher than the exposures to be hedged and does not hold or issue derivatives for trading purposes. All exchange agreements are over-the-counter instruments.

In December 2002, the Company terminated certain interest-rate exchange agreements to effectively create fixed-rate financing for \$1.8 billion of debt at interest rates that were near all-time low yields, and to reduce the potential exposure in the Company's future interest expense due to a rise in interest rates.

In managing the impact of interest-rate changes and foreign currency fluctuations, the Company uses interest-rate exchange agreements and finances in the currencies in which assets are denominated. All derivatives were recorded at fair value in the Company's Consolidated balance sheet at December 31, 2002 as follows: miscellaneous other assets—\$134 million; other long-term liabilities (excluding interest)—\$39 million; and accrued payroll and other liabilities—\$24 million. See summary of significant accounting policies related to financial instruments on page 21 for additional information regarding their use and the impact of SFAS No. 133 regarding derivatives.

The Company uses foreign currency debt and derivatives to hedge certain foreign currency royalties, intercompany financings and long-term investments in foreign subsidiaries and affiliates. This reduces the impact of fluctuating foreign currencies on cash flows and shareholders' equity. Total foreign currency denominated debt, including the effects of foreign currency exchange agreements, was \$6.2 billion and \$5.0 billion at year-end 2002 and 2001, respectively.

The Company does not have significant exposure to any individual counterparty and has master agreements that contain netting arrangements. Certain of these agreements also require each party to post collateral if credit ratings fall below, or aggregate exposures exceed, certain contractual limits. During 2002, certain counterparties were required to post collateral as aggregate exposures exceeded certain contractual limits due to increased values. At December 31, 2002, collateral in the amount of \$2.2 million was posted by a counterparty while the Company was not required to collateralize any of its obligations.

The Company actively hedges selected currencies to minimize the cash exposure of foreign currency royalty and other payments received in the U.S. In addition, where practical, McDonald's restaurants purchase goods and services in local currencies resulting in natural hedges, and the Company typically finances in local currencies, creating economic hedges.

The Company's net asset exposure is diversified among a broad basket of currencies. At year-end 2002 and 2001, assets in hyperinflationary markets were principally financed in U.S. Dollars. The Company's largest net asset exposures (defined as foreign currency assets less foreign currency liabilities) at year end were as follows:

#### Foreign currency net asset exposures

IN MILLIONS OF U.S. DOLLARS	2002	2001
Euro	<b>\$1,536</b>	\$1,251
British Pounds Sterling	<b>700</b>	786
Canadian Dollars	<b>808</b>	738
Australian Dollars	<b>620</b>	516
Brazilian Reals	<b>385</b>	490

The Company prepared sensitivity analyses of its financial instruments to determine the impact of hypothetical changes in interest rates and foreign currency exchange rates on the Company's results of operations, cash flows and the fair value of its financial instruments. The interest-rate analysis assumed a one percentage point adverse change in interest rates on all financial instruments but did not consider the effects of the reduced level of economic activity that could exist in such an environment. The foreign currency rate analysis assumed that each foreign currency rate would change by 10% in the same direction relative to the U.S. Dollar on all financial instruments; however, the analysis did not include the potential impact on sales levels or local currency prices or the effect of fluctuating currencies on the Company's anticipated foreign currency royalties and other payments received in the U.S. Based on the results of these analyses of the Company's financial instruments, neither a one percentage point adverse change in interest rates from 2002 levels nor a 10% adverse change in foreign currency rates from 2002 levels would materially affect the Company's results of operations, cash flows or the fair value of its financial instruments.

#### CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The Company has long-term contractual obligations primarily in the form of lease obligations (related to both Company-operated and franchised restaurants) and debt obligations. In addition, the Company has long-term revenue and cash flow streams that relate to its franchise arrangements. Cash provided by operations (including cash provided by these franchise arrangements) along with our borrowing capacity and other sources of cash will be used to satisfy the obligations. The following table summarizes the Company's contractual obligations and their aggregate maturities as well as future minimum rent payments due to the Company under existing franchise arrangements as of December 31, 2002. (See discussions of cash flows, financial position and capital resources as well as the Notes to the December 31, 2002 consolidated financial statements for further details.)

**Contractual cash flows**

IN MILLIONS	Outflows		Inflows
	Operating leases	Debt obligations <sup>(1)</sup>	Minimum rent under franchise arrangements
2003	\$ 913	\$ 337	\$ 1,735
2004	848	975	1,707
2005	789	2,017	1,662
2006	735	1,014	1,613
2007	683	663	1,566
Thereafter	6,059	4,609	13,127
Total	\$10,027	\$9,615	\$21,410

(1) The maturities reflect reclassifications of short-term obligations to long-term obligations of \$810 million in 2005 and \$500 million thereafter as they are supported by long-term line of credit agreements. Debt obligations do not include \$365 million of SFAS No. 133 fair value adjustments.

In addition to long-term obligations, the Company had guaranteed certain affiliate and other loans totaling \$102 million at December 31, 2002.

**OUTLOOK FOR 2003**

> The Company's strategies for 2003 are designed to reverse the negative comparable sales trend through a heightened focus on restaurant-level execution and marketing. The Company's outlook remains cautious until we see improved performance in our major markets. As a guideline, generally one percentage point of comparable sales in the U.S. impacts annual earnings per share by 1.5 cents and one percentage point of comparable sales in Europe impacts annual earnings per share by about 1 cent, assuming no change in profit margins.

> The Company expects the total amount of selling, general & administrative expenses in 2003 to be relatively flat in constant currencies compared with 2002.

> A significant part of McDonald's operating income is from outside the U.S. and more than 60% of total debt is denominated in foreign currencies. The Euro and the British Pound are the most significant currencies impacting our business. If the Euro and the British Pound move 10% (compared with 2002 average rates), McDonald's annual reported earnings per share would change by about 4 cents to 5 cents.

> The Company expects to decrease its debt level in 2003, excluding the impact of foreign currency exchange rates.

> The Company expects its 2003 effective income tax rate to be in the range of 33.5% to 34.5%.

> The Company is currently reviewing its previously announced plans for capital expenditures and restaurant openings for 2003 and expects to reduce both its capital expenditures and restaurant openings compared with 2002. The plans are expected to be finalized and communicated in early April.

**OTHER MATTERS****CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Management's discussion and analysis of financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses as well as related disclosures. On an ongoing basis, the Company evaluates its estimates and judgments based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

The Company annually reviews its financial reporting and disclosure practices and accounting policies to ensure that they provide accurate and transparent information relative to the current economic and business environment. The Company believes that of its significant accounting policies the following involve a higher degree of judgment and/or complexity. (See summary of significant accounting policies more fully described on pages 20 through 24.)

*Property and equipment*

Property and equipment are depreciated or amortized on a straight-line basis over their useful lives based on management's estimates of the period over which the assets will generate revenue. The useful lives are estimated based on historical experience with similar assets, taking into account anticipated technological or other changes. The Company periodically reviews these lives relative to physical factors, economic factors and industry trends. If there are changes in the planned use of property and equipment or if technological changes were to occur more rapidly than anticipated, the useful lives assigned to these assets may need to be shortened, resulting in the recognition of increased depreciation and amortization expense in future periods.

*Long-lived assets*

Long-lived assets (including goodwill) are reviewed for impairment annually and whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In assessing the recoverability of the Company's long-lived assets, the Company considers changes in economic conditions and makes assumptions regarding estimated future cash flows and other factors. Estimates of future cash flows are judgments based on the Company's experience and knowledge of operations. These estimates can be significantly impacted by many factors including changes in global and local business and economic conditions, operating costs, inflation, competition, and consumer and demographic trends. If the Company's estimates or the underlying assumptions change in the future, the Company may be required to record impairment charges.



#### *Restructuring and litigation accruals*

In 2002 and 2001, the Company recorded charges related to restructuring markets, eliminating positions and strategic changes. The accruals recorded included estimates pertaining to employee termination costs and remaining lease obligations for closed facilities. Although the Company does not anticipate significant changes, the actual costs may differ from these estimates.

From time to time, the Company is subject to proceedings, lawsuits and other claims related to franchisees, suppliers, employees, customers and competitors. The Company is required to assess the likelihood of any adverse judgments or outcomes to these matters as well as potential ranges of probable losses. A determination of the amount of accrual required, if any, for these contingencies is made after careful analysis of each matter. The required accrual may change in the future due to new developments in each matter or changes in approach such as a change in settlement strategy in dealing with these matters. The Company does not believe that any such matter will have a material adverse effect on its financial condition or results of operations.

#### *Income taxes*

The Company records a valuation allowance to reduce its deferred tax assets if it is more likely than not that some portion or all of the deferred assets will not be realized. While the Company has considered future taxable income and ongoing prudent and feasible tax strategies in assessing the need for the valuation allowance, if these estimates and assumptions change in the future, the Company may be required to adjust its valuation allowance. This could result in a charge to, or an increase in, income in the period such determination is made.

Deferred U.S. income taxes have not been recorded for basis differences totaling \$3.2 billion related to investments in certain foreign subsidiaries or affiliates. The basis differences consist primarily of undistributed earnings considered permanently invested in the businesses. If management's intentions change in the future, deferred taxes may need to be provided.

In addition, the Company operates within multiple taxing jurisdictions and is subject to audit in these jurisdictions. The Company records accruals for the estimated outcomes of these audits, and the accruals may change in the future due to new developments in each matter.

#### NEW ACCOUNTING STANDARDS

##### *Asset retirement obligations*

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, *Accounting for Asset Retirement Obligations*, effective January 1, 2003. The Statement requires legal obligations associated with the retirement of long-lived assets to be recognized at their fair value at the time that the obligations are incurred. Upon initial recognition of a liability, the cost will be capitalized as part of the related long-lived asset and allocated to expense over the useful life of the asset.

Application of the new rules, which for the Company relates to lease obligations in certain international markets, is expected to result in a cumulative effect of adoption in the

first quarter 2003 that will reduce net income and shareholders' equity by \$30 million to \$40 million. The adoption of the new rules is not expected to have a material effect on the Company's ongoing results of operations or financial position.

##### *Variable interest entities*

In January 2003, the Financial Accounting Standards Board issued FASB Interpretation No. 46 (FIN No. 46), *Consolidation of Variable Interest Entities*, which requires an enterprise to consolidate or make certain disclosures about variable interest entities that meet certain criteria, effective July 1, 2003. The Company is currently performing an analysis to determine the applicability of FIN No. 46 to SCC. See summary of significant accounting policies on page 23 for further details.

#### EFFECTS OF CHANGING PRICES—INFLATION

The Company has demonstrated an ability to manage inflationary cost increases effectively. This is because of rapid inventory turnover, the ability to adjust menu prices, cost controls and substantial property holdings—many of which are at fixed costs and partly financed by debt made less expensive by inflation. In hyperinflationary markets, menu board prices typically are adjusted to keep pace with inflation, mitigating the effect on reported results.

#### FORWARD-LOOKING STATEMENTS

Certain forward-looking statements are included in this report. They use such words as "may," "will," "expect," "believe," "plan" and other similar terminology. These statements reflect management's current expectations regarding future events and operating performance and speak only as of the date of this report. These forward-looking statements involve a number of risks and uncertainties. The following are some of the factors that could cause actual results to differ materially from those expressed in or underlying our forward-looking statements: effectiveness of operating initiatives; success in advertising and promotional efforts; changes in global and local business and economic conditions, including their impact on consumer confidence; fluctuations in currency exchange and interest rates; food, labor and other operating costs; political or economic instability in local markets, including the effects of war and terrorist activities; competition, including pricing and marketing initiatives and new product offerings by the Company's competitors; consumer preferences or perceptions concerning the Company's product offerings; spending patterns and demographic trends; availability of qualified restaurant personnel; severe weather conditions; existence of positive or negative publicity regarding the Company or its industry generally; effects of legal claims; cost and deployment of capital; changes in future effective tax rates; changes in governmental regulations; and changes in applicable accounting policies and practices. The foregoing list of important factors is not all inclusive.

The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## Consolidated statement of income

IN MILLIONS, EXCEPT PER SHARE DATA

Years ended December 31, **2002**

2001

2000

<b>REVENUES</b>			
Sales by Company-operated restaurants	<b>\$11,499.6</b>	\$11,040.7	\$10,467.0
Revenues from franchised and affiliated restaurants	<b>3,906.1</b>	3,829.3	3,776.0
<b>Total revenues</b>	<b>15,405.7</b>	14,870.0	14,243.0
<b>OPERATING COSTS AND EXPENSES</b>			
Company-operated restaurant expenses			
Food & paper	<b>3,917.4</b>	3,802.1	3,557.1
Payroll & employee benefits	<b>3,078.2</b>	2,901.2	2,690.2
Occupancy & other operating expenses	<b>2,911.0</b>	2,750.4	2,502.8
Franchised restaurants—occupancy expenses	<b>840.1</b>	800.2	772.3
Selling, general & administrative expenses	<b>1,712.8</b>	1,661.7	1,587.3
Other operating (income) expense, net	<b>833.3</b>	257.4	(196.4)
<b>Total operating costs and expenses</b>	<b>13,292.8</b>	12,173.0	10,913.3
<b>Operating income</b>	<b>2,112.9</b>	2,697.0	3,329.7
Interest expense—net of capitalized interest of \$14.3, \$15.2 and \$16.3	<b>374.1</b>	452.4	429.9
McDonald's Japan IPO gain		(137.1)	
Nonoperating expense, net	<b>76.7</b>	52.0	17.5
<b>Income before provision for income taxes and cumulative effect of accounting change</b>	<b>1,662.1</b>	2,329.7	2,882.3
Provision for income taxes	<b>670.0</b>	693.1	905.0
<b>Income before cumulative effect of accounting change</b>	<b>992.1</b>	1,636.6	1,977.3
Cumulative effect of accounting change, net of tax benefit of \$17.6	<b>(98.6)</b>		
<b>Net income</b>	<b>\$ 893.5</b>	\$ 1,636.6	\$ 1,977.3
<b>Per common share—basic:</b>			
Income before cumulative effect of accounting change	<b>\$ .78</b>	\$ 1.27	\$ 1.49
Cumulative effect of accounting change	<b>(.08)</b>		
Net income	<b>\$ .70</b>	\$ 1.27	\$ 1.49
<b>Per common share—diluted:</b>			
Income before cumulative effect of accounting change	<b>\$ .77</b>	\$ 1.25	\$ 1.46
Cumulative effect of accounting change	<b>(.07)</b>		
Net income	<b>\$ .70</b>	\$ 1.25	\$ 1.46
<b>Dividends per common share</b>	<b>\$ .24</b>	\$ .23	\$ .22
<b>Weighted-average shares—basic</b>	<b>1,273.1</b>	1,289.7	1,323.2
<b>Weighted-average shares—diluted</b>	<b>1,281.5</b>	1,309.3	1,356.5

See notes to consolidated financial statements.

## Consolidated balance sheet

McDonald's Corporation 17

IN MILLIONS, EXCEPT PER SHARE DATA

December 31, **2002**

2001

### ASSETS

#### Current assets

Cash and equivalents	\$ 330.4	\$ 418.1
Accounts and notes receivable	855.3	881.9
Inventories, at cost, not in excess of market	111.7	105.5
Prepaid expenses and other current assets	418.0	413.8
<b>Total current assets</b>	<b>1,715.4</b>	1,819.3

#### Other assets

Investments in and advances to affiliates	1,037.7	990.2
Goodwill, net	1,559.8	1,320.4
Miscellaneous	1,074.2	1,115.1
<b>Total other assets</b>	<b>3,671.7</b>	3,425.7

#### Property and equipment

Property and equipment, at cost	26,218.6	24,106.0
Accumulated depreciation and amortization	(7,635.2)	(6,816.5)

#### Net property and equipment

18,583.4 17,289.5

<b>Total assets</b>	<b>\$23,970.5</b>	\$22,534.5
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### LIABILITIES AND SHAREHOLDERS' EQUITY

#### Current liabilities

Notes payable	\$ 0.3	\$ 184.9
Accounts payable	635.8	689.5
Income taxes	16.3	20.4
Other taxes	191.8	180.4
Accrued interest	199.4	170.6
Accrued restructuring and restaurant closing costs	328.5	144.2
Accrued payroll and other liabilities	774.7	680.7
Current maturities of long-term debt	275.5	177.6
<b>Total current liabilities</b>	<b>2,422.3</b>	2,248.3

#### Long-term debt

9,703.6 8,555.5

#### Other long-term liabilities and minority interests

560.0 629.3

#### Deferred income taxes

1,003.7 1,112.2

#### Common equity put options and forward contracts

500.8

#### Shareholders' equity

Preferred stock, no par value; authorized—165.0 million shares; issued—none

Common stock, \$.01 par value; authorized—3.5 billion shares;  
issued—1,660.6 million shares

16.6 16.6

Additional paid-in capital

1,747.3 1,591.2

Unearned ESOP compensation

(98.4) (106.7)

Retained earnings

19,204.4 18,608.3

Accumulated other comprehensive income (loss)

(1,601.3) (1,708.8)

Common stock in treasury, at cost; 392.4 and 379.9 million shares

(8,987.7) (8,912.2)

#### Total shareholders' equity

10,280.9 9,488.4

<b>Total liabilities and shareholders' equity</b>	<b>\$23,970.5</b>	\$22,534.5
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See notes to consolidated financial statements.



## Consolidated statement of cash flows

IN MILLIONS	Years ended December 31, <b>2002</b>	2001	2000
<b>Operating activities</b>			
Net income	<b>\$ 893.5</b>	\$ 1,636.6	\$ 1,977.3
Adjustments to reconcile to cash provided by operations			
Cumulative effect of accounting change	<b>98.6</b>		
Depreciation and amortization	<b>1,050.8</b>	1,086.3	1,010.7
Deferred income taxes	<b>(44.6)</b>	(87.6)	60.5
Changes in working capital items			
Accounts receivable	<b>1.6</b>	(104.7)	(67.2)
Inventories, prepaid expenses and other current assets	<b>(38.1)</b>	(62.9)	(29.6)
Accounts payable	<b>(11.2)</b>	10.2	89.7
Taxes and other accrued liabilities	<b>448.0</b>	270.4	(45.8)
Other (including noncash portion of significant items)	<b>491.5</b>	(60.0)	(244.1)
<b>Cash provided by operations</b>	<b>2,890.1</b>	2,688.3	2,751.5
<b>Investing activities</b>			
Property and equipment expenditures	<b>(2,003.8)</b>	(1,906.2)	(1,945.1)
Purchases of restaurant businesses	<b>(548.4)</b>	(331.6)	(425.5)
Sales of restaurant businesses and property	<b>369.5</b>	375.9	302.8
Other	<b>(283.9)</b>	(206.3)	(144.8)
<b>Cash used for investing activities</b>	<b>(2,466.6)</b>	(2,068.2)	(2,212.6)
<b>Financing activities</b>			
Net short-term borrowings (repayments)	<b>(606.8)</b>	(248.0)	59.1
Long-term financing issuances	<b>1,502.6</b>	1,694.7	2,381.3
Long-term financing repayments	<b>(750.3)</b>	(919.4)	(761.9)
Treasury stock purchases	<b>(670.2)</b>	(1,068.1)	(2,023.4)
Common stock dividends	<b>(297.4)</b>	(287.7)	(280.7)
Other	<b>310.9</b>	204.8	88.9
<b>Cash used for financing activities</b>	<b>(511.2)</b>	(623.7)	(536.7)
<b>Cash and equivalents increase (decrease)</b>	<b>(87.7)</b>	(3.6)	2.2
Cash and equivalents at beginning of year	<b>418.1</b>	421.7	419.5
<b>Cash and equivalents at end of year</b>	<b>\$ 330.4</b>	\$ 418.1	\$ 421.7
<b>Supplemental cash flow disclosures</b>			
Interest paid	<b>\$ 359.7</b>	\$ 446.9	\$ 469.7
Income taxes paid	<b>572.2</b>	773.8	854.2

See notes to consolidated financial statements.

## Consolidated statement of shareholders' equity

McDonald's Corporation 19

IN MILLIONS, EXCEPT PER SHARE DATA	Common stock issued		Additional paid-in capital	Unearned ESOP compen- sation	Retained earnings	Accumulated other comprehensive income (loss)		Common stock in treasury		Total shareholders' equity
	Shares	Amount				Deferred hedging adjustment	Foreign currency translation	Shares	Amount	
Balance at December 31, 1999	1,660.6	\$16.6	\$1,288.3	\$(133.3)	\$15,562.8	\$ —	\$ (886.8)	(309.8)	\$(6,208.5)	\$ 9,639.1
Net income					1,977.3					1,977.3
Translation adjustments (including taxes of \$65.1)							(400.5)			(400.5)
Comprehensive income										1,576.8
Common stock cash dividends (\$22 per share)					(280.7)					(280.7)
ESOP loan payment				20.1						20.1
Treasury stock purchases								(56.7)	(2,002.2)	(2,002.2)
Common equity put option issuances and expirations, net									25.5	25.5
Stock option exercises and other (including tax benefits of \$80.3)			153.5	(1.8)				10.8	74.1	225.8
Balance at December 31, 2000	1,660.6	16.6	1,441.8	(115.0)	17,259.4	—	(1,287.3)	(355.7)	(8,111.1)	9,204.4
Net income					1,636.6					1,636.6
Translation adjustments (including taxes of \$65.7)							(412.2)			(412.2)
SFAS No.133 transition adjustment (including tax benefits of \$9.2)						(17.0)				(17.0)
Fair value adjustments—cash flow hedges (including taxes of \$1.4)						7.7				7.7
Comprehensive income										1,215.1
Common stock cash dividends (\$23 per share)					(287.7)					(287.7)
ESOP loan payment				8.0						8.0
Treasury stock purchases								(36.1)	(1,090.2)	(1,090.2)
Common equity put option issuances and expirations, net and forward contracts									199.2	199.2
Stock option exercises and other (including tax benefits of \$70.0)			149.4	0.3				11.9	89.9	239.6
Balance at December 31, 2001	1,660.6	16.6	1,591.2	(106.7)	18,608.3	(9.3)	(1,699.5)	(379.9)	(8,912.2)	9,488.4
Net income					893.5					893.5
Translation adjustments (including taxes of \$150.5)							106.7			106.7
Fair value adjustments—cash flow hedges (including taxes of \$3.5)						0.8				0.8
Comprehensive income										1,001.0
Common stock cash dividends (\$24 per share)					(297.4)					(297.4)
ESOP loan payment				7.4						7.4
Treasury stock purchases								(25.6)	(686.9)	(686.9)
Common equity put option expirations and forward contracts settled									500.8	500.8
Stock option exercises and other (including tax benefits of \$61.3)			156.1	0.9				13.1	110.6	267.6
Balance at December 31, 2002	1,660.6	\$16.6	\$1,747.3	\$ (98.4)	\$19,204.4	\$ (8.5)	\$(1,592.8)	(392.4)	\$(8,987.7)	\$10,280.9

See notes to consolidated financial statements.

## Notes to consolidated financial statements

### SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### NATURE OF BUSINESS

The Company operates in the food service industry and primarily operates and franchises quick-service restaurant businesses under the McDonald's brand. The Company also operates other restaurant concepts under its Partner Brands: Boston Market, Chipotle Mexican Grill and Donatos Pizzeria. In addition, McDonald's has a minority ownership in Pret A Manger. In March 2002, the Company sold its Aroma Café business in the U.K.

All restaurants are operated by the Company, or under the terms of franchise arrangements, by franchisees who are independent entrepreneurs or by affiliates operating under joint-venture agreements between the Company and local business people.

#### CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its subsidiaries. Substantially all investments in affiliates owned 50% or less (primarily McDonald's Japan and Pret A Manger) are accounted for by the equity method.

#### ESTIMATES IN FINANCIAL STATEMENTS

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

#### REVENUE RECOGNITION

Sales by Company-operated restaurants are recognized on a cash basis. Revenues from franchised and affiliated restaurants include continuing rent and service fees, initial fees and royalties received from foreign affiliates and developmental licensees. Continuing fees and royalties are recognized in the period earned. Initial fees are recognized upon opening of a restaurant, which is when the Company has performed substantially all initial services required by the franchise arrangement.

#### FOREIGN CURRENCY TRANSLATION

The functional currency of substantially all operations outside the U.S. is the respective local currency, except for a small number of countries with hyperinflationary economies, where the functional currency is the U.S. Dollar.

#### ADVERTISING COSTS

Production costs for radio and television advertising, primarily in the U.S., are expensed when the commercials are initially aired. Advertising expenses included in costs of Company-operated restaurants and in selling, general & administrative expenses were (in millions): 2002—\$647.6; 2001—\$600.9; 2000—\$595.3. In addition, significant advertising expenses are incurred by franchisees through advertising cooperatives in individual markets.

#### STOCK-BASED COMPENSATION

The Company accounts for stock options as prescribed by Accounting Principles Board Opinion No. 25 and discloses pro forma information, as provided by Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*.

Pro forma net income and net income per common share were determined as if the Company had accounted for its employee stock options under the fair value method of SFAS No. 123. The fair value of these options was estimated at the date of grant using an option pricing model. The model was designed to estimate the fair value of exchange-traded options that, unlike employee stock options, can be traded at any time and are fully transferable. In addition, such models require the input of highly subjective assumptions including the expected volatility of the stock price. For pro forma disclosures, the options' estimated fair value was amortized over their vesting period. The following tables present the pro forma disclosures and the weighted-average assumptions used to estimate the fair value of these options.

Pro forma disclosures			
IN MILLIONS, EXCEPT PER SHARE DATA			
	2002	2001	2000
As reported—net income	\$ 893.5	\$1,636.6	\$1,977.3
Deduct: Total stock option compensation expense under fair value method, net of related tax effects	(251.7)	(210.0)	(153.7)
Pro forma—net income	\$ 641.8	\$1,426.6	\$1,823.6
Earnings per share:			
As reported—basic	\$ .70	\$ 1.27	\$ 1.49
Pro forma—basic	\$ .50	\$ 1.11	\$ 1.38
As reported—diluted	\$ .70	\$ 1.25	\$ 1.46
Pro forma—diluted	\$ .50	\$ 1.10	\$ 1.36

Assumptions			
	2002	2001	2000
Expected dividend yield	.75%	.65%	.65%
Expected stock price volatility	27.5%	25.7%	24.1%
Risk-free interest rate	5.25%	5.03%	6.39%
Expected life of options IN YEARS	7	7	7
Weighted-average fair value per option granted	\$ 10.88	\$ 9.93	\$ 14.08

#### PROPERTY AND EQUIPMENT

Property and equipment are stated at cost, with depreciation and amortization provided using the straight-line method over the following estimated useful lives: buildings—up to 40 years; leasehold improvements—the lesser of useful lives of assets or lease terms including option periods; and equipment—three to 12 years.



## GOODWILL

Goodwill represents the excess of cost over the net tangible assets of acquired restaurant businesses. In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, *Business Combinations*, and No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 and includes guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations. SFAS No. 142, effective January 1, 2002, eliminates the amortization of goodwill (and intangible assets deemed to have indefinite lives) and instead subjects it to annual impairment tests. Other intangible assets continue to be amortized over their useful lives. Application of the nonamortization provisions of SFAS No. 142 in 2001 and 2000 would have increased net income by approximately \$30 million (\$0.02 per share) in each year.

The Company's goodwill primarily consists of amounts paid in excess of net tangible assets for (1) purchases of McDonald's restaurants from franchisees, (2) ownership percentage increases in international joint-ventures and (3) acquisitions of other businesses such as Partner Brands. Under SFAS No. 142, goodwill is generally assigned to the reporting units that are expected to benefit from the synergies of the combination. The Company has defined reporting units as each individual country for McDonald's restaurant business as well as each individual Partner Brand.

The annual goodwill impairment test compares the fair value of a reporting unit, generally based on discounted cash flows, with its carrying amount including goodwill. If the carrying amount of a reporting unit exceeds its fair value, an impairment loss is measured as the difference between the fair value of reporting unit goodwill and the carrying amount of goodwill.

The Company performed the initial required goodwill impairment test as of January 1, 2002 and recorded a noncash pretax charge of \$116.2 million (\$98.6 million after tax or \$0.07 per diluted share) for the cumulative effect of this accounting change. The impaired goodwill resulted primarily from businesses in Argentina, Uruguay and other markets in Latin America and the Middle East, where economies have weakened significantly in recent years. In addition, the Company completed its annual impairment testing of goodwill in the fourth quarter of 2002, which resulted in no significant charges.

The carrying amount of goodwill totaled \$1,559.8 million and \$1,320.4 million as of December 31, 2002 and 2001, respectively (U.S.—\$676.3, \$516.7; Europe—\$353.5, \$278.6; Asia/Pacific, Middle East and Africa (APMEA)—\$211.0, \$171.3; Latin America—\$97.3, \$158.5; Canada—\$77.5, \$51.2; and Partner Brands—\$144.2, \$144.1). The changes in carrying amounts of goodwill from December 31, 2001 to December 31, 2002 were due to (1) the charge of \$116.2 million for the cumulative effect of the accounting change, (2) goodwill generated in 2002 as a result of purchases of McDonald's restaurant businesses and (3) foreign currency rate fluctuations.

## LONG-LIVED ASSETS

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, long-lived assets are reviewed for impairment annually and whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For purposes of annually reviewing McDonald's restaurant assets for potential impairment, assets are initially grouped together at a television market level in the U.S. and at a country level for each of the international markets. For Partner Brands, assets are grouped by each individual brand. If an indicator of impairment (e.g., negative operating cash flows for the most recent trailing twelve-month period) exists for any grouping of assets, an estimate of undiscounted future cash flows produced by each restaurant within the asset grouping is compared to its carrying value. If an asset is determined to be impaired, the loss is measured by the excess of the carrying amount of the asset over its fair value as determined by an estimate of discounted future cash flows.

Losses on assets held for disposal are recognized when management has approved and committed to a plan to dispose of the assets, and the assets are available for disposal. Generally, such losses relate to either restaurants that have closed and ceased operations or businesses or restaurants that are available for sale.

## FINANCIAL INSTRUMENTS

The Company generally borrows on a long-term basis and is exposed to the impact of interest-rate changes and foreign currency fluctuations. The Company uses foreign currency denominated debt and derivative instruments to manage the impact of these changes. The Company does not use derivatives with a level of complexity or with a risk higher than the exposures to be hedged and does not hold or issue derivatives for trading purposes.

The counterparties to these agreements consist of a diverse group of financial institutions. The Company continually monitors its positions and the credit ratings of its counterparties, and adjusts positions as appropriate. The Company did not have significant exposure to any individual counterparty at December 31, 2002 and has master agreements that contain netting arrangements. Certain of these agreements also require each party to post collateral if credit ratings fall below, or aggregate exposures exceed, certain contractual limits. During 2002, certain counterparties were required to post collateral as aggregate exposures exceeded certain contractual limits due to increased values. At December 31, 2002, collateral in the amount of \$2.2 million was posted by a counterparty while the Company was not required to collateralize any of its obligations.

Effective January 1, 2001, the Company adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. SFAS No. 133 requires companies to recognize all derivatives as either assets or liabilities in the balance sheet at fair value. SFAS No. 133 also requires companies to designate all derivatives that qualify as hedging instruments

as either fair value hedges, cash flow hedges or hedges of net investments in foreign operations. This designation is based upon the exposure being hedged.

The Company recorded a transition adjustment at January 1, 2001 related to cash flow hedges, which reduced accumulated other comprehensive income in shareholders' equity by \$17.0 million, after tax. This adjustment was primarily related to interest-rate exchange agreements used to lock in long-term borrowing rates. The cumulative effect of adopting SFAS No. 133 at January 1, 2001 was not material to the Company's Consolidated statement of income.

All derivatives, primarily interest-rate exchange agreements and foreign currency exchange agreements, were classified in the Company's Consolidated balance sheet at December 31, 2002 as follows: miscellaneous other assets—\$133.9 million; other long-term liabilities (excluding accrued interest)—\$39.2 million; and accrued payroll and other liabilities—\$23.8 million.

#### *Fair value hedges*

The Company enters into fair value hedges to reduce the exposure to changes in the fair value of an asset or a liability, or an identified portion thereof, which is attributable to a particular risk. The types of fair value hedges the Company enters into include: (1) interest-rate exchange agreements to convert a portion of its fixed-rate debt to floating-rate debt and (2) foreign currency exchange agreements for the exchange of various currencies and interest rates. The foreign currency exchange agreements are entered into to hedge the currency risk associated with debt and intercompany loans denominated in foreign currencies, and essentially result in floating-rate assets or liabilities denominated in U.S. Dollars or appropriate functional currencies.

For fair value hedges, the gains or losses on derivatives as well as the offsetting gains or losses on the related hedged items are recognized in current earnings. During the years ended December 31, 2002 and 2001, there was no significant impact to the Company's earnings related to the ineffective portion of fair value hedging instruments.

#### *Cash flow hedges*

The Company enters into cash flow hedges to mitigate the exposure to variability in expected future cash flows attributable to a particular risk. The types of cash flow hedges the Company enters into include: (1) interest-rate exchange agreements that effectively convert a portion of floating-rate debt to fixed-rate debt and are designed to reduce the impact of interest-rate changes on future interest expense, (2) forward foreign exchange contracts and foreign currency options that are designed to protect against the reduction in value of forecasted foreign currency cash flows such as royalties and other payments denominated in foreign currencies, and (3) foreign currency exchange agreements for the exchange of various currencies and interest rates. The foreign currency exchange agreements hedge the currency risk associated with debt and intercompany loans denominated in foreign currencies, and essentially result in fixed-rate assets or liabilities denominated in U.S. Dollars or appropriate functional currencies.

For cash flow hedges, the effective portion of the gains or losses on derivatives is reported in the deferred hedging adjustment component of accumulated other comprehensive income in shareholders' equity and reclassified into earnings in the same period or periods in which the hedged transaction affects earnings. The remaining gain or loss in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in earnings during the period of change. During the years ended December 31, 2002 and 2001, there was no significant impact to the Company's earnings related to the ineffective portion of cash flow hedging instruments.

The Company recorded net increases to the deferred hedging adjustment component of accumulated other comprehensive income in shareholders' equity of \$0.8 million and \$7.7 million, after tax, related to cash flow hedges during the years ended December 31, 2002 and 2001, respectively. Based on interest rates and foreign currency exchange rates at December 31, 2002, no significant amount of deferred hedging adjustments, after tax, included in accumulated other comprehensive income in shareholders' equity at December 31, 2002 will be recognized in earnings in 2003 as the underlying hedged transactions are realized. The maximum maturity date of any cash flow hedge of forecasted transactions at December 31, 2002 was 12 months, excluding instruments hedging forecasted payments of variable interest on existing financial instruments that have various maturity dates through 2011.

#### *Hedges of net investments in foreign operations*

The Company uses forward foreign exchange contracts and foreign currency denominated debt to hedge its investments in certain foreign subsidiaries and affiliates. Realized and unrealized translation adjustments from these hedges are included in shareholders' equity in the foreign currency translation component of accumulated other comprehensive income and offset translation adjustments on the underlying net assets of foreign subsidiaries and affiliates, which also are recorded in accumulated other comprehensive income.

During the year ended December 31, 2002, the Company recorded a net decrease in translation adjustments in accumulated other comprehensive income of \$312.0 million after tax (included in the net increase of \$106.7 million of translation adjustments in the Consolidated statement of shareholders' equity) related primarily to foreign currency denominated debt designated as hedges of net investments. During the year ended December 31, 2001, the Company recorded a net increase in translation adjustments in accumulated other comprehensive income of \$168.5 million after tax related to hedges of net investments.

## VARIABLE INTEREST ENTITIES

In January 2003, the FASB issued Interpretation No. 46 (FIN No. 46), *Consolidation of Variable Interest Entities*, which requires an enterprise to consolidate or make certain disclosures about variable interest entities that meet certain criteria, effective July 1, 2003. If it is reasonably possible that an enterprise will consolidate or disclose information about a variable interest entity on the effective date, the Interpretation requires certain information to be disclosed as of December 31, 2002.

The Company and six unaffiliated companies that supply the "McDonald's System" (McDonald's franchisees, suppliers and the Company) are equal owners of System Capital Corporation (SCC). The Company is currently performing an analysis to determine the applicability of FIN No. 46 to SCC. SCC's purpose is to provide funding to McDonald's franchisees, suppliers to the McDonald's System and McDonald's Corporation and to build equity within SCC that will benefit the McDonald's System. No employees of SCC are employees of the seven shareholders. SCC competes with other lenders who provide similar financing to McDonald's franchisees and suppliers. SCC's function is similar to that of a cooperative and its primary operating activities include (1) providing loans to qualifying U.S. franchisees to purchase existing restaurant businesses as well as finance equipment, buildings and working capital, (2) purchasing accounts receivable and financing inventory and other needs of eligible suppliers and distributors and (3) acquiring land and leasing it to McDonald's Corporation for new restaurants, primarily in the U.S.

The leases are generally for 20 years, provide for up to 20 additional years in renewal options and include an option for the Company to purchase some or all of the real estate subject to the lease at a price equal to SCC's acquisition cost. The Company's commitments under these leases are included in operating lease commitments on pages 14 and 26 and total approximately \$14 million annually based on SCC's current cost of financing.

SCC funds its operations through borrowings by its wholly owned subsidiary, Golden Funding Corp. (Golden Funding). Golden Funding had approximately \$1.7 billion of commercial paper and medium-term notes outstanding at December 31, 2002. SCC assets included \$900 million of loans to McDonald's franchisees, \$500 million of land leased to the Company, and \$300 million of loans to McDonald's suppliers.

Moody's, Standard & Poor's and Fitch periodically review Golden Funding, including reviews of key performance indicators and asset quality. These rating agencies currently rate Golden Funding's commercial paper P-1, A-1 and F1 and its long-term debt Aa2, AA and AA, respectively. Credit support for Golden Funding's financing consists of: \$14 million of cash reserves held by Golden Funding, \$14 million of preferred shares (primarily supplier trade receivables purchased by SCC and contributed to Golden Funding), and a \$30 million letter of credit issued jointly by a syndication of banks.

The Company's investment in SCC is accounted for on the cost basis.

## ASSET RETIREMENT OBLIGATIONS

In June 2001, the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligations*, effective January 1, 2003. The Statement requires legal obligations associated with the retirement of long-lived assets to be recognized at their fair value at the time that the obligations are incurred. Upon initial recognition of a liability, the cost will be capitalized as part of the related long-lived asset and allocated to expense over the useful life of the asset.

Application of the new rules, which for the Company relates to lease obligations in certain international markets, is expected to result in a cumulative effect of adoption in the first quarter 2003 that will reduce net income and shareholders' equity by \$30 million to \$40 million. The adoption of the new rules is not expected to have a material effect on the Company's ongoing results of operations or financial position.

## COMMON EQUITY PUT OPTIONS AND FORWARD CONTRACTS

During 2001 and 2000, the Company sold 12.2 million and 16.8 million common equity put options, respectively, in connection with its share repurchase program. Premiums received were recorded in shareholders' equity as a reduction of the cost of treasury stock purchased and were \$31.8 million in 2001 and \$56.0 million in 2000. In 2002, 10.1 million common equity put options were exercised and 2.1 million options expired unexercised, while 21.0 million options were exercised in 2001. The total amount paid to acquire these shares as a result of the options being exercised was \$286 million in 2002 and \$700 million in 2001. At December 31, 2002, there were no common equity put options outstanding. At December 31, 2001, the \$350.0 million total exercise price of outstanding options was classified in common equity put options and forward contracts in the Consolidated balance sheet, and the related offset was recorded in common stock in treasury, net of premiums received.

During 2001, the Company also entered into equity forward contracts in connection with its share repurchase program. At December 31, 2001, the \$150.8 million total purchase price of the forward contracts was classified in common equity put options and forward contracts in the Consolidated balance sheet, and the related offset was recorded in common stock in treasury. The forward contracts for 5.5 million shares settled in March 2002, and there were no forward contracts outstanding at December 31, 2002.

## SALES OF STOCK BY SUBSIDIARIES AND AFFILIATES

As permitted by Staff Accounting Bulletin No. 51 issued by the Securities and Exchange Commission, when a subsidiary or affiliate sells unissued shares in a public offering, the Company records an adjustment to reflect an increase or decrease in the carrying value of its investment and a resulting nonoperating gain or loss.



## PER COMMON SHARE INFORMATION

Diluted net income per common share is calculated using net income divided by diluted weighted-average shares. Diluted weighted-average shares include weighted-average shares outstanding plus the dilutive effect of stock options, calculated using the treasury stock method. The dilutive effect of stock options was (in millions of shares): 2002–8.4; 2001–19.6; 2000–33.3. Stock options that were not included in diluted weighted-average shares because they would have been antidilutive were (in millions of shares): 2002–148.0; 2001–83.1; 2000–49.2. The dilutive effect of common equity put options and forward contracts in 2001 and 2000 was not significant.

## STATEMENT OF CASH FLOWS

The Company considers short-term, highly liquid investments to be cash equivalents. The impact of fluctuating foreign currencies on cash and equivalents was not material.

## OTHER OPERATING (INCOME) EXPENSE, NET

IN MILLIONS	2002	2001	2000
Gains on sales of restaurant businesses	<b>\$(113.6)</b>	\$(112.4)	\$ (86.9)
Equity in earnings of unconsolidated affiliates	<b>(24.1)</b>	(62.7)	(120.9)
Team service system payments	<b>21.6</b>		
Bad debts and other expense	<b>96.2</b>	54.9	11.4
Significant items:			
Restructuring charges	<b>266.9</b>	200.0	
Restaurant closings/asset impairment	<b>402.4</b>	135.2	
Technology write-offs and other charges	<b>183.9</b>	42.4	
Total significant items	<b>853.2</b>	377.6	
Other operating (income) expense, net	<b>\$ 833.3</b>	\$ 257.4	\$(196.4)

## TEAM SERVICE SYSTEM PAYMENTS

In 2002, the Company made payments to U.S. owner/operators to facilitate the introduction of a new front counter team service system.

## RESTRUCTURING CHARGES

In 2002, the Company recorded \$266.9 million of pretax charges (\$243.6 million after tax) related to transferring ownership in four countries in the Middle East and Latin America, ceasing operations in three countries in Latin America, eliminating positions (approximately 600 positions, about half of which were in the U.S. and half of which were in international markets) and reallocating resources and consolidating certain home office facilities to control costs.

The 2002 charges consisted of: \$136.8 million of asset write-offs and losses on the sale of assets and \$64.6 million of costs for leases and other obligations in the markets restructured or exited, \$55.9 million of severance and other employee-related costs, \$14.7 million of lease cancellation and other costs related to the closing of certain home office facilities, and \$9.9 million of payments made to facilitate a change of ownership from U.S. franchisees who have had a history of financial difficulty and consequently were unable to deliver the level of operational excellence needed to succeed in the future.

These charges were partially offset by a \$15.0 million reversal of accrued restructuring costs recorded in 2001, primarily due to lower employee-related costs than originally estimated.

In 2001, the Company recorded \$200.0 million of pretax charges (\$136.1 million after tax) related to strategic changes and restaurant initiatives in the U.S. and certain international markets. The changes in the U.S. included streamlining operations by reducing the number of regions and divisions, enabling the Company to combine staff functions. In connection with these initiatives, the Company eliminated approximately 850 positions, consisting of 700 positions in the U.S., primarily in the divisions and regions, and 150 positions in international markets.

The 2001 charges consisted of: \$114.4 million of severance and other employee-related costs, \$68.8 million of lease cancellation and other costs related to the closing of region and division facilities, and \$16.8 million of other cash costs, primarily consisting of payments made to facilitate a change of ownership from U.S. franchisees who have had a history of financial difficulty and consequently were unable to deliver the level of operational excellence needed to succeed in the future.

## RESTAURANT CLOSINGS/ASSET IMPAIRMENT

In 2002, the Company recorded \$402.4 million of pretax charges (\$335.8 million after tax) consisting of: \$302.3 million related to management's decision to close 751 underperforming restaurants (234 were closed in 2002 and 517 will close throughout 2003) primarily in the U.S. and Japan, and \$100.1 million primarily related to the impairment of assets for certain existing restaurants in Europe and Latin America.

In 2001, the Company recorded \$135.2 million of pretax charges (\$106.3 million after tax) consisting of: \$91.2 million related to the closing of 163 underperforming restaurants in international markets in 2001, a \$24.0 million asset impairment charge due to an assessment of the ongoing impact of Turkey's significant currency devaluation on our business, and \$20.0 million related to the disposition of Aroma Café in the U.K.

## TECHNOLOGY WRITE-OFFS AND OTHER CHARGES

In 2002, the Company recorded \$183.9 million of pretax charges (\$120.5 million after tax) consisting of: \$170.0 million primarily related to the write-off of software development costs as a result of management's decision to terminate a long-term technology project, and \$13.9 million primarily related to the write-off of receivables and inventory in Venezuela as a result of the temporary closure of all McDonald's restaurants due to the national strike that began in early December.

In 2001, the Company recorded \$42.4 million of pretax charges (\$29.1 million after tax) consisting of: \$17.4 million primarily related to the write-off of certain technology, and \$25.0 million primarily related to the unrecoverable costs incurred in connection with the theft of winning game pieces from the Company's Monopoly and certain other promotional games over an extended period of time, and the related termination of the supplier of the game pieces. Fifty individuals (none of whom were Company employees) were convicted of conspiracy and/or mail fraud charges.

The following table presents the activity included in accrued restructuring and restaurant closing costs in the Consolidated balance sheet.

IN MILLIONS	2001 activity			Liability at December 31, 2001	2002 activity			Liability at December 31, 2002
	Provision	Cash	Noncash		Provision	Cash	Noncash	
Restructuring charges:								
Asset write-offs	\$ 10.0		\$ (10.0)	–	<b>\$141.7</b>		<b>\$(141.7)</b>	–
Employee-related costs	114.4	\$(34.6)		\$ 79.8	<b>40.9</b>	<b>\$(48.4)</b>		<b>\$ 72.3</b>
Lease termination and other	75.6	(29.4)		46.2	<b>84.3</b>	<b>(27.2)</b>		<b>103.3</b>
	200.0	(64.0)	(10.0)	126.0	<b>266.9</b>	<b>(75.6)</b>	<b>(141.7)</b>	<b>175.6</b>
Restaurant closings/asset impairment:								
Asset write-offs	119.0		(119.0)	–	<b>282.3</b>		<b>(282.3)</b>	–
Lease termination and other	16.2	(5.1)		11.1	<b>120.1</b>	<b>(2.8)</b>		<b>128.4</b>
	135.2	(5.1)	(119.0)	11.1	<b>402.4</b>	<b>(2.8)</b>	<b>(282.3)</b>	<b>128.4</b>
Technology write-offs and other charges:								
Asset write-offs	17.4		(17.4)	–	<b>164.4</b>		<b>(164.4)</b>	–
Other	25.0	(17.9)		7.1	<b>19.5</b>	<b>(2.1)</b>		<b>24.5</b>
	42.4	(17.9)	(17.4)	7.1	<b>183.9</b>	<b>(2.1)</b>	<b>(164.4)</b>	<b>24.5</b>
Total accrued restructuring and restaurant closing costs	<b>\$377.6</b>	<b>\$(87.0)</b>	<b>\$(146.4)</b>	<b>\$144.2</b>	<b>\$853.2</b>	<b>\$(80.5)</b>	<b>\$(588.4)</b>	<b>\$328.5</b>

Employee severance is paid in installments over a period of up to one year after termination, and the remaining lease payments for closed facilities will generally be paid through 2020. No significant adjustments have been made to the original plans approved by management.

#### McDONALD'S JAPAN INITIAL PUBLIC OFFERING (IPO) GAIN

In 2001, McDonald's Japan, the Company's largest market in the APMEA segment, completed an IPO of 12 million shares. The Company owns 50% of McDonald's Japan, while the Company's founding partner Den Fujita and his family own approximately 26%. The Company recorded a \$137.1 million gain (pre and after tax) in nonoperating income to reflect an increase in the carrying value of its investment as a result of the cash proceeds from the IPO received by McDonald's Japan.

#### FRANCHISE ARRANGEMENTS

Individual franchise arrangements generally include a lease and a license and provide for payment of initial fees, as well as continuing rent and service fees to the Company based upon a percent of sales with minimum rent payments. McDonald's franchisees are granted the right to operate a restaurant using the McDonald's system and, in certain cases, the use of a restaurant facility, generally for a period of 20 years. Franchisees pay related occupancy costs including property taxes, insurance and maintenance. In addition, franchisees outside the U.S. generally pay a refundable, noninterest-bearing security deposit. Foreign affiliates and developmental licensees pay a royalty to the Company based upon a percent of sales.

The results of operations of restaurant businesses purchased and sold in transactions with franchisees, affiliates and others were not material to the consolidated financial statements for periods prior to purchase and sale.

Revenues from franchised and affiliated restaurants consisted of:

IN MILLIONS	2002	2001	2000
Minimum rents	<b>\$1,479.9</b>	\$1,477.9	\$1,465.3
Percent rent and service fees	<b>2,375.1</b>	2,290.2	2,247.0
Initial fees	<b>51.1</b>	61.2	63.7
Revenues from franchised and affiliated restaurants	<b>\$3,906.1</b>	\$3,829.3	\$3,776.0

Future minimum rent payments due to the Company under existing franchise arrangements are:

IN MILLIONS	Owned sites	Leased sites	Total
2003	\$ 989.5	\$ 745.6	\$ 1,735.1
2004	972.8	734.3	1,707.1
2005	949.6	712.6	1,662.2
2006	922.6	690.4	1,613.0
2007	891.8	674.3	1,566.1
Thereafter	7,367.7	5,758.9	13,126.6
Total minimum payments	\$12,094.0	\$9,316.1	\$21,410.1

At December 31, 2002, net property and equipment under franchise arrangements totaled \$9.5 billion (including land of \$2.8 billion) after deducting accumulated depreciation and amortization of \$4.0 billion.

#### INCOME TAXES

Income before provision for income taxes and cumulative effect of accounting change, classified by source of income, was as follows:

IN MILLIONS	2002	2001	2000
U.S.	<b>\$ 876.3</b>	\$ 958.2	\$1,280.6
Outside the U.S.	<b>785.8</b>	1,371.5	1,601.7
Income before provision for income taxes and cumulative effect of accounting change	<b>\$1,662.1</b>	\$2,329.7	\$2,882.3

The provision for income taxes, classified by the timing and location of payment, was as follows:

IN MILLIONS	2002	2001	2000
U.S. federal	\$307.0	\$357.3	\$361.1
U.S. state	54.6	59.7	77.0
Outside the U.S.	353.0	363.7	406.4
Current tax provision	714.6	780.7	844.5
U.S. federal	(47.4)	57.7	75.2
U.S. state	(7.6)	4.3	9.5
Outside the U.S.	10.4	(149.6)	(24.2)
Deferred tax provision (benefit) <sup>(1)</sup>	(44.6)	(87.6)	60.5
Provision for income taxes	\$670.0	\$693.1	\$905.0

(1) Includes the benefit of tax law changes in certain international markets of \$147.3 million in 2001. Amounts in 2002 and 2000 were not significant.

Net deferred tax liabilities consisted of:

IN MILLIONS	December 31, 2002	2001
Property and equipment	\$ 1,316.3	\$1,304.4
Other	448.4	429.9
Total deferred tax liabilities	1,764.7	1,734.3
Intangible assets	(199.7)	(207.9)
Operating loss carryforwards	(186.1)	(166.0)
Employee benefit plans	(129.7)	(137.2)
Property and equipment	(89.4)	(108.8)
Capital loss carryforwards	(88.0)	
Foreign tax credit carryforwards	(45.0)	(21.6)
Other	(450.9)	(258.4)
Total deferred tax assets before valuation allowance	(1,188.8)	(899.9)
Valuation allowance	322.1	180.1
Net deferred tax liabilities <sup>(1)</sup>	\$ 898.0	\$1,014.5

(1) Net of current tax assets included in prepaid expenses and other current assets in the Consolidated balance sheet (in millions): 2002—\$105.7; 2001—\$97.7.

The statutory U.S. federal income tax rate reconciles to the effective income tax rates as follows:

	2002	2001	2000
Statutory U.S. federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of related federal income tax benefit	2.2	2.1	1.9
Benefits and taxes related to foreign operations <sup>(1)</sup>	(6.3)	(6.5)	(4.8)
Significant items <sup>(2)</sup>	8.7	(1.6)	
Other, net	.7	.8	(.7)
Effective income tax rates	40.3%	29.8%	31.4%

(1) Includes the benefit of tax law changes.

(2) Includes the impact of significant items in other operating (income) expense, net and McDonald's Japan IPO gain. Certain of these items were not tax-affected for financial reporting purposes (see page 2).

Deferred U.S. income taxes have not been recorded for basis differences related to investments in certain foreign subsidiaries and affiliates. These basis differences were approximately \$3.2 billion at December 31, 2002 and consisted primarily of undistributed earnings considered permanently invested in the businesses. Determination of the deferred income tax liability on these unremitted earnings is not practicable because such liability, if any, is dependent on circumstances existing if and when remittance occurs.

## LEASING ARRANGEMENTS

At December 31, 2002, the Company was lessee at 6,871 restaurant locations through ground leases (the Company leases the land and the Company or franchisee owns the building) and at 7,823 restaurant locations through improved leases (the Company leases land and buildings). Lease terms for most restaurants are generally for 20 to 25 years and, in many cases, provide for rent escalations and renewal options, with certain leases providing purchase options. For most locations, the Company is obligated for the related occupancy costs including property taxes, insurance and maintenance. In addition, the Company is lessee under noncancelable leases covering certain offices and vehicles.

Future minimum payments required under existing operating leases with initial terms of one year or more are:

IN MILLIONS	Restaurant	Other	Total
2003	\$ 829.6	\$ 83.3	\$ 912.9
2004	798.1	50.2	848.3
2005	746.1	42.4	788.5
2006	698.8	36.5	735.3
2007	652.3	30.5	682.8
Thereafter	5,893.6	165.1	6,058.7
Total minimum payments	\$9,618.5	\$408.0	\$10,026.5

Rent expense was (in millions): 2002—\$1,032.5; 2001—\$958.6; 2000—\$886.4. These amounts included percent rents in excess of minimum rents (in millions): 2002—\$131.3; 2001—\$119.6; 2000—\$133.0.

## SEGMENT AND GEOGRAPHIC INFORMATION

The Company operates in the food service industry. Substantially all revenues result from the sale of menu products at restaurants operated by the Company, franchisees or affiliates. All intercompany revenues and expenses are eliminated in computing revenues and operating income. Operating income includes the Company's share of operating results of affiliates after interest expense and income taxes, except for U.S. affiliates, which are reported before income taxes. Royalties and other payments received from subsidiaries outside the U.S. were (in millions): 2002—\$644.1; 2001—\$607.7; 2000—\$603.6.

Corporate general & administrative expenses are included in the corporate segment of operating income and consist of home office support costs in areas such as facilities, finance, human resources, information technology, legal, supply chain management and training. Corporate assets include corporate cash and equivalents, asset portions of financing instruments, home office facilities and deferred tax assets.



IN MILLIONS	2002	2001	2000
U.S.	\$ 5,422.7	\$ 5,395.6	\$ 5,259.1
Europe	5,136.0	4,751.8	4,753.9
APMEA	2,367.7	2,203.3	2,101.8
Latin America	813.9	971.3	949.3
Canada	633.6	608.1	615.1
Partner Brands	1,031.8	939.9	563.8
Total revenues	\$15,405.7	\$14,870.0	\$14,243.0
U.S.	\$ 1,673.3	\$ 1,622.5	\$ 1,795.7
Europe	1,021.8	1,063.2	1,180.1
APMEA	64.3	325.0	451.2
Latin America	(133.4)	10.9	102.3
Canada	125.4	123.7	126.3
Partner Brands	(66.8)	(66.5)	(41.5)
Corporate	(571.7)	(381.8)	(284.4)
Total operating income	\$ 2,112.9 <sup>(1)</sup>	\$ 2,697.0 <sup>(2)</sup>	\$ 3,329.7
U.S.	\$ 8,687.4	\$ 8,288.4	\$ 7,856.9
Europe	8,310.6	7,139.1	7,083.7
APMEA	3,332.0	3,144.5	2,983.4
Latin America	1,425.3	1,898.3	1,855.6
Canada	703.2	574.2	552.0
Partner Brands	780.4	637.1	450.7
Corporate	731.6	852.9	901.2
Total assets	\$23,970.5	\$22,534.5	\$21,683.5
U.S.	\$ 752.7	\$ 552.3	\$ 475.6
Europe	579.4	635.8	797.6
APMEA	230.4	275.7	253.5
Latin America	119.9	197.5	245.7
Canada	111.6	80.4	52.5
Partner Brands	190.4	153.3	79.6
Corporate	19.4	11.2	40.6
Total capital expenditures	\$ 2,003.8	\$ 1,906.2	\$ 1,945.1
U.S.	\$ 383.4	\$ 425.0	\$ 402.6
Europe	334.9	313.7	296.5
APMEA	141.7	133.2	129.8
Latin America	59.6	79.3	69.4
Canada	35.6	32.9	34.9
Partner Brands	40.3	36.8	16.6
Corporate	55.3	65.4	60.9
Total depreciation and amortization	\$ 1,050.8	\$ 1,086.3	\$ 1,010.7

(1) Includes \$853.2 million of charges (U.S.—\$99.2; Europe—\$147.8; APMEA—\$222.3; Latin America—\$142.3; Canada—\$9.7; Partner Brands—\$34.0; and Corporate—\$197.9) primarily related to restructuring markets and eliminating positions, restaurant closings/asset impairment and the write-off of technology costs. See other operating (income) expense, net note for further discussion.

(2) Includes \$377.6 million of charges (U.S.—\$181.0; Europe—\$45.8; APMEA—\$41.5; Latin America—\$40.4; Canada—\$9.8; Partner Brands—\$24.9; and Corporate—\$34.2) primarily related to the U.S. business reorganization and other global change initiatives, and restaurant closings/asset impairment. See other operating (income) expense, net note for further discussion.

Total long-lived assets, primarily property and equipment, were (in millions)—Consolidated: 2002—\$21,976.6; 2001—\$20,355.3; 2000—\$19,798.3. U.S. based: 2002—\$9,254.3; 2001—\$8,670.4; 2000—\$8,373.2.

## DEBT FINANCING

### LINE OF CREDIT AGREEMENTS

At December 31, 2002, the Company had several line of credit agreements with various banks totaling \$1.3 billion, all

of which remained unused at year-end 2002. Subsequent to year end, the Company renegotiated the line of credit agreements as follows: \$810.0 million of lines expiring in 2004 with a term of 364 days and fees based on current credit ratings of .05% per annum on the total commitment, with a feature that allows the Company to convert the borrowings to a one-year loan at expiration; a \$500.0 million line expiring in 2008 with fees based on current credit ratings of .07% per annum on the total commitment; and a \$25.0 million line expiring in 2003 with a term of 364 days and fees of .07% per annum on the total commitment. Fees and interest rates on these lines are based on the Company's long-term credit rating assigned by Moody's and Standard & Poor's. Under terms of these agreements, the Company is required to maintain a minimum net worth (defined as consolidated assets less consolidated liabilities) of \$5 billion. In addition, certain subsidiaries outside the U.S. had unused lines of credit totaling \$1.1 billion at December 31, 2002; these were principally short-term and denominated in various currencies at local market rates of interest.

The weighted-average interest rate of short-term borrowings, consisting of commercial paper and foreign currency bank line borrowings, was 3.4% at both December 31, 2002 and December 31, 2001.

### FAIR VALUES

At December 31, 2002, the fair value of the Company's debt and notes payable obligations was estimated at \$10.5 billion compared to a carrying amount of \$10.0 billion. This fair value was estimated using various pricing models or discounted cash flow analyses that incorporated quoted market prices. The Company has no current plans to retire a significant amount of its debt prior to maturity.

The carrying amounts for both cash and equivalents and notes receivable approximate fair value. Foreign currency and interest-rate exchange agreements, foreign currency options and forward foreign exchange contracts were recorded in the Consolidated balance sheet at fair value using various pricing models or discounted cash flow analyses that incorporated quoted market prices. No fair value was estimated for noninterest-bearing security deposits by franchisees, because these deposits are an integral part of the overall franchise arrangements.

### ESOP LOANS AND OTHER GUARANTEES

At December 31, 2002, the Company has guaranteed and included in total debt \$22.6 million of Notes issued by the Leveraged Employee Stock Ownership Plan (ESOP) with payments through 2006. Borrowings related to the ESOP at December 31, 2002, which include \$85.9 million of loans from the Company to the ESOP and the \$22.6 million of Notes guaranteed by the Company, are reflected as long-term debt with a corresponding reduction of shareholders' equity (unearned ESOP compensation). The ESOP is repaying the loans and interest through 2018 using Company contributions and dividends from its McDonald's common stock holdings. As the principal amount of the borrowings is repaid, the debt and the unearned ESOP compensation are being reduced.

The Company also has guaranteed certain affiliate and other loans totaling \$102.0 million at December 31, 2002. These guarantees are contingent commitments issued by the Company generally to support borrowing arrangements of certain U.S. partnerships and franchisees, and certain affiliates. The terms of the guarantees vary and are equal to the remaining term of the related debt. At December 31, 2002, there was no carrying value for obligations under these guarantees in the Company's Consolidated balance sheet.

DEBT OBLIGATIONS

The Company has incurred debt obligations principally through public and private offerings and bank loans. There are no provisions in the Company's debt obligations that would accelerate repayment of debt as a result of a change in credit ratings. Certain of the Company's debt obligations contain cross-acceleration provisions and restrictions on Company and subsidiary mortgages and the long-term debt of certain subsidiaries. Under certain agreements, the Company has the option to retire debt prior to maturity, either at par or at a premium over par.

The following table summarizes the Company's debt obligations (the interest rates reflected in the table include the effects of interest-rate and foreign currency exchange agreements).

IN MILLIONS OF U.S. DOLLARS	Maturity dates	Interest rates <sup>(1)</sup>		Amounts outstanding	
		2002	2001	2002	2001
Fixed—original issue <sup>(2)</sup>		5.2%	6.2%	\$3,659.4	\$3,293.8
Fixed—converted via exchange agreements <sup>(3)</sup>		5.2	5.3	(995.4)	(1,829.9)
Floating		1.3	2.3	793.1	2,364.8
Total U.S. Dollars	2003–2033			3,457.1	3,828.7
Fixed		5.5	5.7	677.8	629.7
Floating		3.1	3.5	1,954.7	1,724.9
Total Euro	2003–2012			2,632.5	2,354.6
Fixed		6.2	6.1	1,152.6	698.8
Floating		5.5	5.6	186.1	150.3
Total British Pounds Sterling	2003–2032			1,338.7	849.1
Fixed		6.2	4.5	156.0	276.9
Floating		1.9	6.2	237.3	58.9
Total other European currencies <sup>(4)</sup>	2003–2007			393.3	335.8
Fixed		1.9	2.3	900.4	584.0
Floating			0.1		227.9
Total Japanese Yen	2003–2030			900.4	811.9
Fixed		7.2	7.1	455.8	317.6
Floating		4.8	6.2	415.7	300.0
Total other Asia/Pacific currencies <sup>(5)</sup>	2003–2008			871.5	617.6
Fixed		4.8	5.8	3.2	3.2
Floating		3.2	15.5	17.9	23.2
Total other currencies	2003–2016			21.1	26.4
Debt obligations before fair value adjustments <sup>(6)</sup>				9,614.6	8,824.1
Fair value adjustments <sup>(7)</sup>				364.8	93.9
Total debt obligations <sup>(8)</sup>				\$9,979.4	\$8,918.0

- (1) Weighted-average effective rate, computed on a semiannual basis.
- (2) Includes \$150 million of debentures that mature in 2027, which are subordinated to senior debt and which provide for the ability to defer interest payments up to five years under certain conditions.
- (3) A portion of U.S. Dollar fixed-rate debt effectively has been converted into other currencies and/or into floating-rate debt through the use of exchange agreements. The rates shown reflect the fixed rate on the receivable portion of the exchange agreements. All other obligations in this table reflect the net effects of these and other exchange agreements.
- (4) Primarily consists of Swiss Francs, Swedish Kronor and Danish Kroner.
- (5) Primarily consists of Korean Won, Chinese Renminbi, New Taiwanese Dollars and Hong Kong Dollars.
- (6) Aggregate maturities for 2002 debt balances, before fair value adjustments, are as follows (in millions): 2003–\$337.4; 2004–\$974.8; 2005–\$2,016.7; 2006–\$1,013.6; 2007–\$662.7; and thereafter–\$4,609.4. These amounts include reclassifications of short-term obligations to long-term obligations of \$810.0 in 2005 and \$500.0 thereafter, as they are supported by the long-term line of credit agreements discussed on page 27.
- (7) SFAS No. 133 requires that the underlying items in fair value hedges, in this case debt obligations, be recorded at fair value. The related hedging instrument is also recorded at fair value in either miscellaneous other assets or other long-term liabilities. A portion (\$155.9 million) of the adjustments at December 31, 2002 related to interest-rate exchange agreements that were terminated in December 2002 and will amortize as a reduction to interest expense over the remaining life of the related debt.
- (8) Includes notes payable, current maturities of long-term debt and long-term debt included in the Consolidated balance sheet. The increase in debt obligations from December 31, 2001 to December 31, 2002 was due to the impact of changes in exchange rates on foreign currency-denominated debt (\$645.0 million), SFAS No. 133 fair value adjustments (\$270.9 million) and an increase in net borrowings (\$145.5 million).

PROPERTY AND EQUIPMENT

Net property and equipment consisted of:

IN MILLIONS	December 31, 2002	2001
Land	\$ 4,169.6	\$ 3,975.6
Buildings and improvements on owned land	8,747.2	8,127.0
Buildings and improvements on leased land	8,872.5	8,020.2
Equipment, signs and seating	3,765.1	3,371.7
Other	664.2	611.5
	26,218.6	24,106.0
Accumulated depreciation and amortization	(7,635.2)	(6,816.5)
Net property and equipment	\$18,583.4	\$17,289.5

Depreciation and amortization expense was (in millions): 2002–\$971.1; 2001–\$945.6; 2000–\$900.9.

EMPLOYEE BENEFIT PLANS

The Company's Profit Sharing and Savings Plan for U.S.-based employees includes profit sharing, 401(k) and leveraged employee stock ownership (ESOP) features. The 401(k) feature allows participants to make pretax contributions that are partly matched from shares released under the ESOP. McDonald's executives, staff and restaurant managers participate in additional ESOP allocations and profit sharing contributions, based on their compensation. The profit sharing contribution is discretionary, and the Company determines the amount each year.

Participant 401(k) contributions, the Company's matching contributions, profit sharing contributions and any related earnings can be invested in McDonald's common stock or among several other investment alternatives. ESOP allocations are generally invested in McDonald's common stock.

In addition, the Company maintains a nonqualified, unfunded Supplemental Plan that allows participants to make tax-deferred contributions and receive Company-provided allocations that cannot be made under the Profit Sharing and Savings Plan because of Internal Revenue Service limitations. The investment alternatives and returns in the Supplemental Plan are based on certain of the investment alternatives under the Profit Sharing and Savings Plan. Total liabilities under the Supplemental Plan were \$297.3 million at December 31, 2002 and \$301.1 million at December 31, 2001 and were included in other long-term liabilities in the Consolidated balance sheet.

The Company has entered into derivative contracts to hedge changes in the Supplemental Plan liabilities. At December 31, 2002, derivatives with a fair value of \$34.5 million indexed to the Company's stock and \$38.4 million indexed to certain market indices were included in miscellaneous other assets in the Consolidated balance sheet. All changes in Plan liabilities and in the fair value of the derivatives are recorded in selling, general & administrative expenses. Changes in fair value of the derivatives indexed to the Company's stock are recorded in the Consolidated statement of income because the contracts provide the counterparty with a choice of cash settlement or settlement in shares.

Total U.S. costs for the Profit Sharing and Savings Plan, including nonqualified benefits and related hedging activities, were (in millions): 2002—\$50.1; 2001—\$54.6; 2000—\$49.6.

Certain subsidiaries outside the U.S. also offer profit sharing, stock purchase or other similar benefit plans. Total plan costs outside the U.S. were (in millions): 2002—\$36.8; 2001—\$39.7; 2000—\$38.1.

Other postretirement benefits and postemployment benefits, excluding severance benefits related to the 2002 and 2001 restructuring charges, were immaterial.

## STOCK OPTIONS

At December 31, 2002, the Company had five stock-based compensation plans for employees and nonemployee directors. Options to purchase common stock are granted at the fair market value of the stock on the date of grant. Therefore, no compensation cost has been recognized in the Consolidated statement of income for these plans.

Substantially all of the options become exercisable in four equal installments, beginning a year from the date of the grant, and expire 10 years from the grant date. In 2001, the Board of Directors approved a three-year extension to the term of 44.2 million options granted between May 1, 1999

and December 31, 2000 with an exercise price greater than \$28.90. Because the market value of the stock was less than the exercise price of the options at the time of extension, no compensation expense was required to be recorded.

Also in 2001, the Board of Directors approved a special grant of 11.9 million options at a price of \$28.90 as an incentive to meet an operating income performance goal for calendar year 2003. The options vest on January 31, 2004, and if the performance goal is met, the options will retain their original 10-year term; otherwise, they will expire on June 30, 2004. The Company does not expect to meet this performance goal.

At December 31, 2002, the number of shares of common stock reserved for issuance under the plans was 231.9 million, including 33.0 million available for future grants. A summary of the status of the Company's plans as of December 31, 2002, 2001 and 2000, and changes during the years then ended, is presented in the following table.

Options	2002		2001		2000	
	Shares	Weighted-average exercise price	Shares	Weighted-average exercise price	Shares	Weighted-average exercise price
	IN MILLIONS		IN MILLIONS		IN MILLIONS	
Outstanding at beginning of year	192.9	\$26.65	175.8	\$25.34	164.7	\$23.06
Granted <sup>(1)</sup>	26.3	28.26	38.6	29.37	26.5	35.16
Exercised	(13.1)	14.91	(11.9)	13.70	(10.8)	13.68
Forfeited	(7.2)	29.22	(9.6)	29.03	(4.6)	27.81
Outstanding at end of year	198.9	\$27.57	192.9	\$26.65	175.8	\$25.34
Exercisable at end of year	110.9		98.2		79.3	

(1) Includes the special grant in 2001 of 11.9 million options discussed above.

Options granted each year were 2.1%, 3.0% and 2.0% of weighted-average common shares outstanding for 2002, 2001 and 2000, representing grants to approximately 13,900, 15,100, and 14,100 employees in those three years.

The following table presents information related to options outstanding and options exercisable at December 31, 2002, based on ranges of exercise prices.

Range of exercise prices	December 31, 2002			
	Options outstanding		Options exercisable	
	Number of options	Weighted-average remaining contractual life	Number of options	Weighted-average exercise price
	IN MILLIONS	IN YEARS	IN MILLIONS	
\$12 to 22	31.9	1.9	30.6	\$15.30
23 to 27	62.8	4.5	42.3	24.75
28 to 34	59.5	7.4	8.1	29.59
35 to 46	44.7	9.6	29.9	38.28
\$12 to 46	198.9	6.1	110.9	\$26.14

## Quarterly results (unaudited)

	Quarters ended December 31		Quarters ended September 30		Quarters ended June 30		Quarters ended March 31	
IN MILLIONS, EXCEPT PER SHARE DATA	2002	2001	2002	2001	2002	2001	2002	2001
<b>Revenues</b>								
Sales by Company-operated restaurants	\$ 2,932.8	\$ 2,811.4	\$ 3,019.3	\$ 2,876.9	\$ 2,869.0	\$ 2,738.2	\$2,678.5	\$2,614.2
Revenues from franchised and affiliated restaurants	966.4	960.1	1,027.7	1,002.4	993.1	969.3	918.9	897.5
<b>Total revenues</b>	<b>3,899.2</b>	<b>3,771.5</b>	<b>4,047.0</b>	<b>3,879.3</b>	<b>3,862.1</b>	<b>3,707.5</b>	<b>3,597.4</b>	<b>3,511.7</b>
<b>Company-operated margin</b>	<b>374.5</b>	383.5	<b>434.5</b>	436.1	<b>415.1</b>	396.6	<b>368.9</b>	370.8
<b>Franchised margin</b>	<b>749.2</b>	758.1	<b>813.5</b>	799.0	<b>787.1</b>	771.4	<b>716.2</b>	700.6
<b>Operating income (loss)</b>	<b>(203.4)<sup>(1)</sup></b>	482.7 <sup>(2)</sup>	<b>829.8</b>	746.6 <sup>(3)</sup>	<b>845.2</b>	772.5 <sup>(4)</sup>	<b>641.3<sup>(5)</sup></b>	695.2
<b>Income (loss) before cumulative effect of accounting change</b>	<b>\$ (343.8)<sup>(1)</sup></b>	\$ 271.9 <sup>(2)</sup>	<b>\$ 486.7</b>	\$ 545.5 <sup>(3)</sup>	<b>\$ 497.5</b>	\$ 440.9 <sup>(4)</sup>	<b>\$ 351.7<sup>(5)</sup></b>	\$ 378.3
Cumulative effect of accounting change, net of tax							<b>(98.6)</b>	
<b>Net income (loss)</b>	<b>\$ (343.8)<sup>(1)</sup></b>	\$ 271.9 <sup>(2)</sup>	<b>\$ 486.7</b>	\$ 545.5 <sup>(3)</sup>	<b>\$ 497.5</b>	\$ 440.9 <sup>(4)</sup>	<b>\$ 253.1<sup>(6)</sup></b>	\$ 378.3
<b>Per common share—basic:</b>								
<b>Income (loss) before cumulative effect of accounting change</b>	<b>\$ (.27)<sup>(1)</sup></b>	\$ .21 <sup>(2)</sup>	<b>\$ .38</b>	\$ .42 <sup>(3)</sup>	<b>\$ .39</b>	\$ .34 <sup>(4)</sup>	<b>\$ .28<sup>(5)</sup></b>	\$ .29
Cumulative effect of accounting change							<b>(.08)</b>	
<b>Net income (loss)</b>	<b>\$ (.27)<sup>(1)</sup></b>	\$ .21 <sup>(2)</sup>	<b>\$ .38</b>	\$ .42 <sup>(3)</sup>	<b>\$ .39</b>	\$ .34 <sup>(4)</sup>	<b>\$ .20<sup>(6)</sup></b>	\$ .29
<b>Per common share—diluted:</b>								
<b>Income (loss) before cumulative effect of accounting change</b>	<b>\$ (.27)<sup>(1)</sup></b>	\$ .21 <sup>(2)</sup>	<b>\$ .38</b>	\$ .42 <sup>(3)</sup>	<b>\$ .39</b>	\$ .34 <sup>(4)</sup>	<b>\$ .27<sup>(5)</sup></b>	\$ .29
Cumulative effect of accounting change							<b>(.07)</b>	
<b>Net income (loss)</b>	<b>\$ (.27)<sup>(1)</sup></b>	\$ .21 <sup>(2)</sup>	<b>\$ .38</b>	\$ .42 <sup>(3)</sup>	<b>\$ .39</b>	\$ .34 <sup>(4)</sup>	<b>\$ .20<sup>(6)</sup></b>	\$ .29
<b>Dividends per common share</b>	<b>\$ .235</b>	\$ .225	<b>\$ —</b>	\$ —	<b>\$ —</b>	\$ —	<b>\$ —</b>	\$ —
<b>Weighted-average shares—basic</b>	<b>1,268.8</b>	1,282.7	<b>1,273.1</b>	1,286.1	<b>1,273.2</b>	1,289.7	<b>1,277.2</b>	1,300.7
<b>Weighted-average shares—diluted</b>	<b>1,268.8</b>	1,299.3	<b>1,280.5</b>	1,305.8	<b>1,290.6</b>	1,311.1	<b>1,292.7</b>	1,325.3
<b>Systemwide sales<sup>(7)</sup></b>	<b>\$10,489.5</b>	\$10,112.7	<b>\$10,908.1</b>	\$10,629.2	<b>\$10,429.9</b>	\$10,238.8	<b>\$9,698.5</b>	\$9,649.7
<b>Market price per common share</b>								
High	<b>\$ 19.95</b>	\$ 30.10	<b>\$ 28.62</b>	\$ 31.00	<b>\$ 30.72</b>	\$ 30.96	<b>\$ 29.06</b>	\$ 35.06
Low	<b>15.17</b>	25.00	<b>17.42</b>	26.00	<b>27.00</b>	25.39	<b>25.38</b>	24.75
Close	<b>16.08</b>	26.47	<b>17.66</b>	27.14	<b>28.45</b>	27.06	<b>27.75</b>	26.55

(1) Includes the following pretax charges totaling \$0.52 per share:

- > \$266.9 million (\$243.6 million after tax) primarily related to transferring ownership in four countries in the Middle East and Latin America, ceasing operations in three countries in Latin America and eliminating positions, reallocating resources and consolidating certain home office facilities to control costs.
- > \$359.4 million (\$292.8 million after tax) consisting of \$292.2 million related to management's decision to close 719 underperforming restaurants (202 were closed in 2002 and 517 will close throughout 2003), mainly in the U.S. and Japan, and \$67.2 million primarily related to the impairment of assets for certain existing restaurants in Europe and Latin America.
- > \$183.9 million (\$120.5 million after tax) consisting of \$170.0 million related to management's decision to terminate a long-term technology project, and \$13.9 million primarily related to the write-off of receivables and inventory in Venezuela as a result of the temporary closure of all McDonald's restaurants due to the national strike that began in early December.

(2) Includes the following pretax charges totaling \$0.13 per share:

- > \$200.0 million (\$136.1 million after tax) related to strategic changes and restaurant initiatives in the U.S. and certain international markets.
- > \$25.0 million (\$17.0 million after tax) primarily related to unrecoverable costs incurred in connection with the theft of winning game pieces and the related termination of the supplier.
- > \$27.1 million (\$18.4 million after tax) consisting of a \$20.0 million asset impairment charge related to the disposition of Aroma Café and \$7.1 million primarily related to the closing of nine underperforming restaurants in international markets.

(3) Includes the following pretax charges totaling \$101.5 million:

- > \$84.1 million (\$63.9 million after tax) primarily related to the closing of 154 underperforming restaurants in international markets.
- > \$17.4 million (\$12.1 million after tax) primarily related to the write-off of certain technology.

(4) Includes a \$24.0 million asset impairment charge (pre and after tax or \$0.01 per share) in Turkey.

(5) Includes \$43.0 million of asset impairment charges (pre and after tax or \$0.03 per share), primarily related to the impairment of assets in existing restaurants in Chile and other Latin American markets and the closing of 32 underperforming restaurants in Turkey, as a result of continuing economic weakness.

(6) Includes net pretax income of \$23.2 million (\$53.0 million of income after tax or \$0.04 per share) consisting of the \$101.5 million pretax charges noted in (3) above, a \$137.1 million gain (pre and after tax) on the initial public offering of McDonald's Japan and a \$12.4 million pretax charge (\$8.1 million after tax) primarily related to the write-off of a corporate investment.

(7) Systemwide sales include sales by all restaurants, whether operated by the Company, by franchisees or by affiliates operating under joint-venture agreements. See page 4 for further discussion.



## Management's report

McDonald's Corporation 31

Management is responsible for the preparation, integrity and fair presentation of the consolidated financial statements and notes to the consolidated financial statements. The financial statements were prepared in accordance with accounting principles generally accepted in the U.S. and include certain amounts based on management's judgment and best estimates. Other financial information presented is consistent with the financial statements.

The Company maintains a system of internal controls over financial reporting including safeguarding of assets against unauthorized acquisition, use or disposition, which is designed to provide reasonable assurance to the Company's management and Board of Directors regarding the preparation of reliable published financial statements and asset safeguarding. The system includes a documented organizational structure and appropriate division of responsibilities; established policies and procedures that are communicated throughout the Company; careful selection, training, and development of our people; and utilization of an internal audit program. Policies and procedures prescribe that the Company and all employees are to maintain high standards of proper business practices throughout the world.

There are inherent limitations to the effectiveness of any system of internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation and safeguarding of assets. Furthermore, the effectiveness of an internal control system can change with circumstances. The Company believes that it maintains an effective system of internal control over financial reporting and safeguarding of assets against unauthorized acquisition, use or disposition.

The consolidated financial statements have been audited by independent auditors, Ernst & Young LLP, who were given unrestricted access to all financial records and related data. The audit report of Ernst & Young LLP is presented herein.

The Board of Directors, operating through its Audit Committee composed entirely of independent Directors, provides oversight to the financial reporting process. Ernst & Young LLP has unrestricted access to the Audit Committee and regularly meets with the Committee to discuss accounting, auditing and financial reporting matters.

McDONALD'S CORPORATION  
January 23, 2003

## Report of independent auditors

The Board of Directors and Shareholders  
McDonald's Corporation

We have audited the accompanying Consolidated balance sheets of McDonald's Corporation as of December 31, 2002 and 2001, and the related Consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of McDonald's Corporation management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the U.S. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of McDonald's Corporation at December 31, 2002 and 2001, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the U.S.

As discussed in the Notes to the consolidated financial statements, effective January 1, 2002, the Company changed its method for accounting for goodwill to conform with SFAS No. 142, *Goodwill and Other Intangible Assets*. Effective January 1, 2001, the Company changed its method for accounting for derivative financial instruments to conform with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

ERNST & YOUNG LLP  
Chicago, Illinois  
January 23, 2003

McDONALD'S ANNUAL REPORT  
ON FORM 10-K

Shareholders may obtain a copy of the Company's 2002 Annual Report to the Securities and Exchange Commission (SEC) on Form 10-K by going to the investor section of McDonald's website at [www.mcdonalds.com](http://www.mcdonalds.com), by going to the SEC's website at [www.sec.gov](http://www.sec.gov) or by calling us at 1-630-623-7428. This information is also available at no charge by sending a request to the Company's Investor Relations Service Center, McDonald's Plaza, Oak Brook, Illinois 60523.

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